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Sup. Ct. U.S.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 430

THE UNITED STATES OF AMERICA, PETITIONER

vs.

OGILVIE HARDWARE COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 22, 1946
CERTIORARI GRANTED OCTOBER 14, 1946

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UNITED STATES DISTRICT COURT,
WESTERN DISTRICT OF LOUISIANA,
SHREVEPORT DIVISION.

No. 1256 Civil.

OGILVIE HARDWARE COMPANY, INC.,

versus

UNITED STATES OF AMERICA.

TRANSCRIPT OF APPEAL

Taken by Defendant to the United States Circuit Court of Appeals, Fifth Circuit, New Orleans, Louisiana.

Appearances:
H. C. Walker, Esquire,
Elias Goldstein, Esquire,
Attorneys for Complainant—Appellee.

Malcolm E. Lafargue, Esquire, U. S. District Attorney,
William J. Fleniken, Esquire, Assistant U. S. Attorney,
Attorneys for Defendant—Appellant.

United States District Court, Western District of Louisiana,
Shreveport Division.

Ogilvie Hardware Company, Inc.,
vs. No. 1256.
United States of America.

To the Honorable Judges of the United States District Court for the Western District of Louisiana, Shreveport Division:

The Petition of the Ogilvie Hardware Company, Inc., a corporation organized under the laws of the State of

Louisiana and domiciled in the Parish of Caddo, with respect represents:

1.

This is a suit for refund of income taxes erroneously assessed and the jurisdiction of the Court is derived from Section 24 (20) of the Judicial Code, 28 U. S. C. A., Section 41 (20).

2.

Petitioner was organized a number of years ago and has since its organization conducted a wholesale hardware business in the City of Shreveport. For income tax purposes your petitioner operates on a fiscal year basis instead of a calendar year basis, its fiscal year ending May 31st of each year.

3.

For the fiscal year ending May 31st, 1937 it reported a net income for federal income tax purposes of Twenty-seven Thousand Three Hundred Seventy-eight and 64/100 ($27,378.64) Dollars and paid income tax thereon of Three Thousand Five Hundred Five and 65/100 ($3,505.65) Dollars. The Internal Revenue Department of the United States determined that the income tax return as prepared and submitted by petition was erroneous and that petitioner owed in addition to the amount which it had paid Six Thousand Two Hundred Forty-nine and 21/100 ($6,249.21) Dollars. of which amount Five Thousand Four Hundred Twenty-six and 93/100 ($5,426.93) Dollars represented surtax on undistributed profits.

4.

For the fiscal year ending May 31st, 1938, your petitioner reported a net income of Eighteen Thousand Five Hundred

Forty-six and 96/100 ($18,546.96) Dollars, upon which it paid a tax of Three Thousand Six Hundred Fifty-six and 25/100 ($3,656.25) Dollars. The Internal Revenue Department of the United States held this return likewise to be erroneous and assessed an additional tax of One Thousand Four Hundred Eighty-eight and 86/100 ($1,488.86) Dollars, which likewise represented a surtax on undistributed profits.

5.

Your petitioner paid the deficiency assessment for the fiscal year ending May 31st, 1937, in installments as follows:

August 13th, 1937	$ 45.56
November 15th, 1937	$ 45.56
February 11th, 1938	$ 45.57
May 12th, 1938	$ 45.57
October 5th, 1938	$1,311.17
January 4th, 1939	$1,311.17
April 4th, 1939	$1,311.17
July 5th, 1939	$1,311.16

Your petitioner paid the deficiency assessment against it for the year ending May 31st, 1938 as follows:

August 12, 1938	$372.21
November 14th, 1938	$372.21
February 14th, 1939	$372.22
May 5th, 1939	$372.22

6.

On November 25th, 1942, following the passage of the 1942 Revenue Act by the Congress of the United States

of America, your petitioner filed a claim for refund of these amounts because at the close of its fiscal years ending May 31st, 1936, May 31st, 1937, and May 31st, 1938, it had a large deficit in accumulated earnings and profits, which deficit on each of the three dates named exceeded the total amount of its net income for the fiscal years ending May 31st, 1937 and May 31st, 1938; and petitioner was prohibited by Louisiana law (Act 250 of the Louisiana Legislature for the year 1928) from paying dividends during the existence of such deficit.

7.

Petitioner's claim for refund was approved by the subordinate officials of the Internal Revenue Department to whom it was presented as required by the regulations of the Commissioner of Internal Revenue; but on January 22nd, 1944, petitioner received a communication dated November 25th, 1943, which advised your petitioner that the claim had been rejected in full. Your petitioner promptly filed a protest, requested a hearing which was granted and then filed a supplemental protest; but in spite of these protests the claim for refund was rejected by the Commissioner of Internal Revenue, notice of this rejection being given to your petitioner by a letter dated August 18th, 1944 from Mr. William G. Cullen, Head of the Southwestern Division Technical Staff of the Internal Revenue Department of the United States.

8.

Your petitioner further with respect shows that it had a deficit of Seventy-four Thousand Eight Hundred Seventy-five and 10/100 ($74,875.10) Dollars in accumulated earnings and profits as of the close of its fiscal year ending May [redacted]st, 1936, and that it had a similar deficit at the

close of its fiscal year ending May 31st, 1937 of Seventy-one Thousand Three Hundred Forty-seven and 18/100 ($71,347.18) Dollars; that under the provisions of Act 250 of the Louisiana Legislature for the year 1928, which has been continuously in effect since its enactment and is the general corporation law of Louisiana, it was prohibited from paying dividends during the existence of a deficit in accumulated earnings and profits and was in fact prohibited from paying dividends except out of surplus; and your petitioner shows that at no time during the years 1936, 1937 and 1938 did it have a surplus. Petitioner further shows that the amount of its deficit in accumulated earnings and profits as of the close of the preceding taxable year exceeded its total net income for the fiscal year ending May 31st, 1937, and the amount of its deficit in accumulated earnings and profits as of the close of the fiscal year ending May 31st, 1937, exceeded its net income for the fiscal year ending May 31st, 1938.

9.

A copy of this petition has been sent by registered mail to the Attorney General of the United States of America, Washington, D. C.

Wherefore, your petitioner prays that service be made herein upon the United States of America as provided by law and that a copy of this petition be served upon the United States District Attorney for the Western District of Louisiana and that after all legal delays and due hearing had there be judgment in favor of petitioner and against the United States of America in the full sum of Six Thousand Nine Hundred and Fifteen and 79/100 ($6,915.79) Dollars with interest at the rate of six per cent (6%) per annum upon:

$45.56 from August 13th, 1937,
$45.56 from November 15th, 1937,

$45.57 from February 11th, 1938,
$45.57 from May 12th, 1938,
$1,311.17 from October 5th, 1938,
$1,311.17 from January 4th, 1939,
$1,311.17 from April 4th, 1939,
$1,311.16 from July 5th, 1939,
$372.21 from August 12th 1938
$372.21 from November 14th, 1938,
$372.22 from February 14th, 1939,
$372.22 from May 15th, 1939.

Petitioner further prays for all necessary orders and general relief.

H. C. WALKER, JR.,
(H. C. Walker, Jr.),
424 First National Bank Building,
Shreveport, Louisiana.

ELIAS GOLDSTEIN,
(Elias Goldstein),
Attorneys for Petitioner.
424 First National Bank Building,
Shreveport, Louisiana.

(Affidavit Omitted.)

Filed November 21, 1944. Philip H. Mecom, Clerk, U. S. District Court, West. Dist. of Louisiana.

ORDER GRANTING EXTENSION OF TIME TO FILE ANSWER OR OTHER PLEADINGS.

No. 1256.

(Titles Omitted.)

On motion of the United States of America and it appearing proper to the Court;

It Is Hereby Ordered that the United States of America, defendant in the above numbered and entitled cause, be granted a further period of sixty (60) days from this day within which to file an answer or other pleadings in this matter.

Thus Done and Signed at Alexandria, Louisiana, on the 16th day of January, 1945.

G. L. PORTERIE,
Judge.

Filed January 17, 1945. Philip H. Mecom, Clerk, U. S. District Court, West. Dist. of Louisiana.

ANSWER.

No. 1256.

(Title Omitted.)

The defendant, United States of America, through its attorneys, Malcolm E. Lafargue, United States Attorney for the Western District of Louisiana, and John A. Patin,

Assistant United States Attorney, answering the complaint:

1.

Admits that this is a suit for refund of income taxes assessed and paid and that the jurisdiction of this Court is based on Section 24(20) of the Judicial Code, 28 U. S. C. A., paragraph 41(20), but denies each and every other allegation of paragraph numbered 1 thereof.

2.

Admits the allegations of paragraph numbered 2 thereof.

3.

Admits that the plaintiff filed an income tax return for the fiscal year ending May 31, 1937, and paid the tax of $3,505.65 shown to be due thereon and that the Internal Revenue Department of the United States determined that the return as filed was erroneous and that the plaintiff owed an additional tax in the amount of $6,249.21, but denies each and every other allegation of paragraph numbered 3 thereof.

Defendant affirmatively alleges that the income tax return filed by the plaintiff showed a net income for excess profits tax purposes of $27,378.64 and a net income for income tax purposes of $27,235.92. Defendant further alleges that of the said additional tax in the amount of $6,249.21 only $5,244.67 represented surtax on undistributed profits instead of the amount of $5,426.93 alleged by plaintiff.

4.

Admits that the plaintiff filed an income tax return for the year ending May 31, 1938, reporting thereon a net

income of $18,546.90 upon which it paid the tax shown thereon to be due in the amount of $3,656.25 and that the Internal Revenue Department of the United States held such return to be erroneous and assessed an additional amount, but denies each and every other allegation of paragraph numbered 4 thereof.

Defendant affirmatively alleges that the additional tax assessed was in the amount of $502.14 plus interest thereon of $37.21 instead of in the amount of $1,488.86 as alleged by the plaintiff in said paragraph numbered 4 thereof.

The defendant further alleges that of the total amount of tax against the plaintiff, including the original tax and the additional tax, $1,488.86 represented a surtax on undistributed profits.

5.

Denies each and every allegation of paragraph numbered 5 thereof.

Defendant affirmatively alleges that the additional tax and interest paid by the plaintiff for the fiscal year ended May 31, 1937, was paid on the following dates and in the following amounts:

October 18, 1938	$1,990.10
January 13, 1939	1,562.31
April 12, 1939	1,562.31
July 14, 1939	1,572.29
July 14, 1939	120.62
Total tax & interest	$6,807.63

Defendant further alleges that the original tax and additional tax for the fiscal year ended May 31, 1938, were paid on the following dates in the following amounts:

Tax Shown to be Due on Return.

August 15, 1938	$ 914.07
November 16, 1938	914.06
February 16, 1939	914.06
May 22, 1939	914.06
Total tax paid	$3,656.25

Additional Tax Paid.

November 25, 1939	$ 162.75
January 27, 1940	125.54
April 4, 1940	125.54
May 28, 1940	125.52
May 28, 1940	7.00
Total paid	$ 546.35

6.

Admits that in November, 1942, the plaintiff filed claims for refund, but denies each and every other allegation of paragraph numbered 6 thereof.

Defendant affirmatively alleges that the said claims for refund were filed on November 27, 1942, instead of on November 25, 1942, as alleged by the plaintiff. Defendant further alleges that a claim in the amount of $5,426.93 was filed for the fiscal year ending May 31, 1937, and a claim for refund in the amount of $1,488.86 was filed for the fiscal year ending May 31, 1938.

7.

Admits that the plaintiff received communications dated November 25, 1943, and August 18, 1944, and that it filed various protests and that in spite of such protests the said claims for refund were rejected by the Commissioner of Internal Revenue, but denies each and every other allegation of paragraph numbered 7 thereof.

The defendant affirmatively alleges that the communication dated November 25, 1943, notified the plaintiff of the rejection of its claim and that the letter dated August 18, 1944, from William G. Cullen, Head of the Southwestern Division, Technical Staff of the Internal Revenue Department of the United States also notified the plaintiff of the rejection of its claims and stated that the statutory notices thereof would be issued in the future.

Defendant further alleges that the Commissioner of Internal Revenue in a registered letter dated November 1, 1944, advised the plaintiff of the rejection of its said claims for refund.

8.

Denies each and every allegation of paragraph numbered 8 thereof.

9.

Admits the allegations of paragraph numbered 9 thereof.

Wherefore, the defendant prays for judgment, dismissing the complaint, together with the costs and disbursements of this action.

MALCOLM E. LAFARGUE,
(Malcolm E. Lafargue),
United States Attorney.
JOHN A. PATIN,
(John A. Patin),
Assistant United States Attorney,
Attorneys for Defendant.

Filed March 13, 1945. Philip H. Mecom, Clerk, U. S. District Court, West. Dist. of Louisiana.

STIPULATION.

No. 1256.

(Titles Omitted.)

It is hereby stipulated by and between the parties hereto, by their respective attorneys, that the following facts may be taken as true upon the trial of this case, subject to the right of either party to introduce other and further evidence not inconsistent with any of the facts stipulated herein:

I. The taxpayer, Ogilvie Hardware Company, Inc., is and at all times in question was a corporation organized under the laws of the State of Louisiana and domiciled in the Parish of Caddo in the Western District of Louisiana. It was organized in 1907 under the name of Thomas-Ogilvie Hardware Company, Limited, and changed to its present name about 1926 or 1927. It conducts a whole-

sale hardware business in the City of Shreveport, reports its income on the accrual basis, and operates on a fiscal year basis ending on May 31st of each year.

II. From the date of its organization through 1918 the taxpayer's authorized and outstanding capital stock consisted of 1,000 shares of common stock of a par value of $100 each, or a total of $100,000 par value outstanding.

III. On August 12, 1918, $100,000 par value of 7 per cent preferred stock was authorized, of which $23,000 was issued in 1919 and $15,300 in 1920 for cash.

IV. On July 7, 1924, a 100 per cent dividend in common stock ($100,000 par value) was issued share for share to its common stockholders, thus making a total outstanding common stock of $200,000 which is still outstanding. The stock dividend was charged to surplus on the books of the taxpayer during the fiscal year 1925 (ending May 31, 1925). The surplus of the corporation at the end of the fiscal year ending May 31, 1924 was $149,306.43. After declaring the 100% stock dividend and charging same to surplus and after payment of a cash dividend of $14,681.00, and after giving effect to the earnings for the year ending May 31, 1924, the corporation still had a surplus of $42,229.70.

V. On January 23, 1934, the articles of incorporation were amended so that two classes of preferred stock would henceforth be outstanding. The two classes were to be designated as Class A and Class B. The old preferred stock referred to hereinbefore in paragraph III became the Class B stock.

VI. On April 18, 1934, the corporation being badly in need of a loan borrowed $23,000 from William C. Woolf

and Mable M. Palmer, for which notes of the taxpayer were given, and as a consideration for their making the loan issued to them $23,000 par value of Class C stock. This stock bonus was charged to surplus on taxpayer's books during the fiscal year which ended May 31, 1934. So long as Class A stock remained outstanding, all of the voting rights, control and management of taxpayer were vested in the holders of such stock.

VII. The loans made by Mr. Woolf and Mrs. Palmer were dated April 18, 1934 and were due July 15, 1935, and were eventually paid in full during the fiscal years ending 1937 and 1938. Part of the Class A preferred stock issued to Mr. Woolf and Mrs. Palmer as a bonus was redeemed in 1940 and 1941 and the remainder was redeemed in 1943 and 1944.

VIII. The taxpayer's books on May 31, 1936 disclosed a deficit of $74,875.10, its net operating losses since the declaration of the stock dividend having been, together with the $23,000 paid as a bonus for the loan made by Mr. Woolf and Mrs. Palmer, sufficient to convert the 1924 surplus into this deficit on May 31, 1936. Likewise, the taxpayer's books showed an operating deficit of $71,347.18 on May 31, 1937 and an operating deficit of $60,923.58 on May 31, 1938.

IX. The dispute in this case relates entirely to the right of the taxpayer to take into consideration in determining the amount of its surplus or deficit, as the case might be, the $100,000 common stock dividend and the $23,000 stock bonus.

X. On August 14, 1937, the taxpayer filed with the Collector of Internal Revenue for the District of Louisiana a corporation income and excess profits tax return for the

fiscal year ending May 31, 1937, showing an income tax of $3,362.93 and excess profits tax of $142.72, or a total of $3,505.65, to be due, which amounts were thereafter paid and are not in issue here.

Upon an examination of the return the Commissioner of Internal Revenue made certain adjustments and assessed additional taxes of $6,249.21, of which $5,426.93 consisted of a surtax on undistributed profits. The records of the Collector of Internal Revenue show that the additional taxes plus interest were paid on the following dates in the following amounts:

October 18, 1938	$1,990.10
January 13, 1939	1,562.31
April 12, 1939	1,562.31
July 14, 1939	1,572.29
July 14, 1939	120.62
	$6,807.63

XI. On August 15, 1938, the taxpayer filed its corporation income and excess-profits tax return for the fiscal year ending May 31, 1938, showing total taxes due of $3,656.25. The records of the Collector's office show such taxes to have been paid as follows:

August 15, 1938	$914.07
November 16, 1938	914.06
February 16, 1939	914.06
May 22, 1939	914.06
	$3,656.25

As a result of an examination of the said return the Commissioner made certain adjustments and assessed additional taxes of $502.14. According to the records of the

Collector's office, the additional taxes with interest thereon were paid as follows:

October 25, 1939	$162.75
January 27, 1940	125.54
April 4, 1940	125.54
May 28, 1940	125.52
	$539.35

Of the total amount of taxes paid by taxpayer for the said fiscal year 1938, $1,488.86 consisted of surtax on undistributed profits. The taxpayer asserts that the amount of $1,488.86 was paid as follows, as evidenced by photostatic copies of the original checks issued by it which are attached hereto and marked "Exhibit B":

August 12, 1938	$ 372.21
November 14, 1938	372.21
February 14, 1939	372.22
May 15, 1939	372.11
	$1,488.86

XII. On November 27, 1942, following the enactment of the Revenue Act of 1942, and particularly of Section 501 (c) thereof, the taxpayer filed claims for refund of surtax on undistributed profits in the amounts of $5,426.98 and $1,488.86 for the fiscal years ending May 31, 1937 and May 31, 1938, respectively. The claims were based on the ground that the taxpayer had a continuous deficit in accumulated earnings and profits on May 31, 1936, on May 31, 1937 and on May 31, 1938, which deficit on each of the three dates named exceeded the total amount of its net income for the fiscal years ending with those dates, and was thus prohibited by Louisiana law from paying dividends.

Under date of November 1, 1944, the Commissioner of Internal Revenue, by a registered letter, notified the taxpayer of the rejection of its said claims in full.

XII. If the Court decides that the taxpayer is entitled to any recovery, whether of the entire amount sought or of a lesser amount, computations will be submitted by the parties to the Court for its determination as to the correct amount of recovery.

ELIAS GOLDSTEIN,
Attorney for Plaintiff.
MALCOLM E. LAFARGUE,
United States Attorney,
Attorney for United States.

Filed July 11, 1945. Philip H. Mecom, Clerk, U. S. District Court, West. Dist. of Louisiana.

OPINION OF JUDGE.

No. 1256.

(Titles Omitted.)

DAWKINS, J.:

The facts in this case are not disputed and are as follows:

The Ogilvie Hardware Company was incorporated in 1907 with a capital stock of 1000 shares of the par value of $100,000.00, issued and outstanding; and on August 12, 1918, $100,000.00 of seven per cent preferred stock was authorized, of which $23,000.00 was issued in 1919 and $15,300.00 in 1920. At the end of the fiscal year, May 31, 1924, the corporation had a surplus of $149,306.43, out of which it declared a stock dividend of 100 per cent and

issued to its shareholders and additional 1000 shares of common stock of the part value of $100,000.00. At the same time it declared a cash dividend of $14,681.00, thus leaving in its surplus the sum of $42,229.70. January 23, 1934, the charter was amended so as to establish two classes of preferred stock, A and B, and the preferred stock authorized and issued on August 12, 1918, became Class B.

On April 18, 1934, the corporation being "badly in need of a loan" borrowed from individuals the sum of $23,000.00, represented by note and, as a bonus or further consideration for the loan, there was issued to the lenders Class A preferred stock of the par value of $23,000.00, which carried with it full voting rights with respect to control and management. The loans of $23,000.00 were due July 15, 1935, but were paid in full "during the fiscal years ending in 1937 and 1938." The preferred stock issued to the lenders was redeemed "partly in 1940 and 1941 and the remainder * * * in 1943 and 1944."

The taxpayer's books, at the end of the fiscal year of May 31, 1936, showed a deficit of $74,875.10, which included "net operating losses since the declaration of the stock dividend in 1924" and the $23,000.00 paid as a bonus in preferred stock Class A in 1934, charged at the time to surplus, but subsequently redeemed as above stated. The books also showed operating deficits in the fiscal years of May 31, 1937 of $71,347.18 and of May 31, 1938, of $60,923.58.

Stipulation IX recites:

"The dispute in this case relates entirely to the right of the taxpayer to take into consideration in determining the amount of its surplus or deficit, as the case might be, the $100,000 common stock dividend and the $23,000 stock bonus."

The taxpayer returned and paid for the year 1937 an income tax in the amount of $3,362.93 and a profits tax of $143.72, or a total of $3,505.65, and for the year 1938 total taxes of $3,656.25. The Commissioner, on examination of the returns of 1937, assessed additional taxes of $6,249.21, of which $5,426.93 consisted of a surtax on undistributed profits, which was paid. A similar reassessment for 1938 resulted in the imposition of additional taxes in the sum of $502.14, which were also paid. Of the total taxes paid for 1938, "$1,488.86 consisted of surtaxes on undistributed profits".

After the passage on November 27, 1942, of the Revenue Act for that year, particularly Section 501(c), the taxpayer filed claims for "refunds of surtaxes on undistributed profits in the amounts of $5,426.93 and $1,488.86 for the fiscal years ending May 31, 1937 and May 31, 1938, respectively * * * on the ground" that the taxpayer had a continuous deficit in accumulated earnings and profits on May 31, 1936, on May 31, 1937, and on May 31, 1938, which deficits, on each of the three dates named, exhausted the total amount of its income for those fiscal years, and it was thus prohibited by the Louisiana law from paying dividends. The claims having been denied, this suit was instituted to recover the full amount of the alleged overpayments, totaling $6,915.79, with six per cent interest from date of each payment.

There are three points of law involved, which, in substance, are as follows:

1st. Whether the stock dividend of 1924 can be said to have diminished the accumulated earnings and profits of the taxpayer within the meaning of Section 26 (c) (3) of the Revenue Act of 1936, as amended by Section 501 of the Revenue Act of 1942;

2nd. Whether within the meaning of the statute as amended "the taxpayer was prohibited by state law from

paying dividends for the fiscal years ending May 31, 1937 and May 31, 1938"; and

3d. If recovery is allowed, from what dates interest should be figured.

Prior to 1936, corporations had been able to escape taxation upon much of their earnings and profits by declaring "stock dividends". The Revenue Act of that year (C. 690, Secs. 13 and 14) imposed income and surtaxes upon the undistributed profits of the corporation, and Section 26 provided the credits which might be taken thereon, among which was (c)(2):

"Disposition of profits of taxable year. An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936."

In order to make clear its purpose to tax undistributed income and profits, the Revenue Act of 1936, Ch. 690, Sec. 115 (h), provided:

"Effect on Earnings and Profits of Distribution of Stock.—The distribution (whether before January 1, 1936, or on and after such date) to a distributee by or on behalf

of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

"(1) If no gain to such distributee from the receipt of such stock or securities was recognized by law, or

"(2) If the distribution was not subject to tax in the hands of such distributee it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under sections 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act. * * *."

The amendment of 1942 was expressly made retroactive and effective as of "the date of the enactment of the Revenue Act of 1936" and any "over-payment shall be refunded or credited in the same manner as in the case of an income tax erroneously collected under the Revenue Act of 1936 * * *." At the time of the stock dividend in the present case in 1924, the revenue law of that year had specifically provided (Sec. 201(f), C. 234, 43 Stat. 253) that stock dividends should not be taxable. It had long since been decided by the Supreme Court (March 8, 1920) that a stock dividend could not constitutionally be taxed in the hands of a stockholder. Eisner vs. McComber, 252 U. S. 189, and, as stated earlier, the Revenue Act of 1936 was a deliberate attempt to reach undistributed profits of all kinds, including those represented by stock dividends, at least from the passage of that law. At the same time it was recognized that there would be instances where the income of the corporation would be pledged by written contracts to pay debts, such as bond issues, etc.; and, hence, that it should not be penalized for failure to distribute income so bound, to its stockholders.

In the case of Helvering, Comm. vs. Northwest Steel Mills, 311 U. S. 45, the Supreme Court decided that such credit could not be taken for that portion of the income or undivided profits which the corporation was prohibited from distributing under state law, but only so much as was covered by "provision of a written contract" as provided in subsections (c) (1) and (c)(2) of Sec. 26 of the Revenue Act of 1936, and that restrictions contained in the charter against the declaration of dividends were not such a contract within the meaning of the statute (as between the state and corporation).

Thereafter the Revenue Act of 1942, Sec. 501, (C. 619, 56 Stat. 798, Sec. 26(c)) amended the Revenue Act of 1936 to read as follows:

"(c) Restrictions on Payment of Dividends.—"; * * *

"(c) Deficit Corporations.—In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936."

After the Supreme Court had decided in the Northwest Steel Mills case, supra, that a corporation could not take credit for income on profits which it was prohibited from distributing under state law or the provisions of the Revenue Act of 1936, Congress, in the passage of the Revenue Act of 1942, drew a "deadline", so to speak, which had the effect of allowing such credits under any such law or order of any public regulatory body "which was in effect prior to May 31, 1936".

Apparently, it saw the possibility of the states or other regulatory bodies passing such laws when they did not

exist on that date. There was no attempt to define or distinguish as between the reasons or grounds by which distribution might be prohibited by state law.

At the time of the stock dividend in this case in 1924, some twelve years before the passage of the Revenue Act of 1936, it was both lawful and justified under the financial condition of the corporation, to declare dividends in stock. There is nothing in the stipulation of facts to question the good faith of the parties or that this stock was treated and handled the same as that originally subscribed insofar as participation in management, profits, etc., or the power of the holders to sell and dispose of it. Its surplus was adjusted by charging it with the value of the additional stock so issued, and continuously thereafter, until the assessment of the deficiencies in 1937 and 1938, its books showed only such surpluses and undivided profits as accrued from year to year without consideration of the $100,000.00 which had represented the stock dividend back in 1924.

Act 250 of the Louisiana Legislature for the year 1928 declares:

"No corporation shall pay dividends in cash or property,

"(a) Except from the surplus of the aggregate of its assets over the aggregate of its liabilities, plus the amount of its capital stock."

This is unquestionably a statutory prohibition against the distribution of the income of a corporation as divdends, without taking into consideration, as against its assets and surplus, the par value of its entire stock as a liability. To this extent, the plaintiff was a "deficit corporation" within the meaning of Section 14 (a) (3) of the Revenue Act of 1936, as amended by Section 51 of the Revenue Act of 1942, 56 Stat. 954.

Numerous authorities are cited on points which appear not to be disputed. However, the two cases most nearly in point are Century Electric Co. vs. Comm., (9th Cir.), 144 Fed. (2d) '983, relied upon by the Government, and Glenn, Collector, vs. Byron Sash and Door Co., (6th Cir.), decided June 18, 1945, not yet reported, cited by plaintiff.

The Court in the first case rests its affirmance of the Tax Court's decision, disallowing a credit for the stock issued against surplus, upon the provisions of Section 115 (h) of the Revenue Act of 1936, declaring that the distribution of non-taxable stock dividends was not to be considered a distribution of earnings, without discussing at least the effect of the amendment of 1942 permitting the taking of credit for earnings or profits which the corporations were prohibited from distributing under the state law.

In the latter, or Byron Sash and Door Co. case, however, in a factual situation very similar to that of the prese t case, the Court went at length into the reasons, intents and purposes of the amendment, and reached a conclusion directly opposite to that in the former. The Court, in this latter case, points out that the deficit was caused by losses over a period of seven years subsequent to the conversion of that part of the surplus into capital stock by the issuance of the stock dividend; whereas, in Century Electric Company, the deficit arose from the acts of the corporation in issuing the stock dividends in those identical years, 1936 and 1937, against earnings and profits. Attention was called to the fact that Section 115(h) of the Revenue Act of 1936 "deals with the factual status of the stockholder who receives the dividend rather than with the liability of the corporation for taxes, and to use this provision of the statute in order to ignore the deficit * * * seems untenable. Moreover, it is based on a false premise, that the deficit was caused by the distribution of the dividends. Actually, the deficit was caused by seven continuous years of operating losses."

Here, too, the deficit arises, not from the stock dividend of some twelve years before, when the corporation was prosperious and fully justified in declaring it, but from operating losses occurring largely in the depths of the depression of the early 1930's.

The discussion and citation of authorities in the Byron Sash and Door Company case are so exhaustive I do not feel that anything could be added by a repetition of those views here. My conclusion is that the plaintiff should recover.

Interest should be calculated from the various dates on which the instalment paid exceeded the taxes actually due. Blair vs. Birkenstock, 271 U. S. 348.

Proper decree should be presented.

Thus Done and Signed in Chambers at Monroe, Louisiana, on this the 2 day of October, 1945.

BEN C. DAWKINS,
United States District Judge.

Filed October 3, 1945. Philip H. Mecom, Clerk, U. S. District Court, West. Dist. of Louisiana.

PETITION FOR REHEARING.

No. 1256.

(Titles Omitted.)

To the Honorable Judges of this Court:

Comes now the United States of America, through Malcolm E. Lafargue, United States Attorney, and William J. Fleniken, Assistant United States Attorney, in the above entitled cause, and presents this, a petition for a re-

hearing of the above entitled cause, and, in support thereof, respectfully shows:

1.

That the judgment is contrary to the law and the evidence.

Wherefore, it is respectfully urged that this petition for a rehearing be granted and that the judgment of this Court be upon further consideration reversed.

Respectfully submitted,
UNITED STATES OF AMERICA,
MALCOLM E. LAFARGUE,
(Malcolm E. Lafargue),
United States Attorny,
WILLIAM J. FLENIKEN,
(William J. Fleniken),
Assistant United States
Attorney.

Filed October 18, 1945. Philip H. Mecom, Clerk, U. S. District Court, West. Dist. of Louisiana.

MINUTE ENTRY.

Shreveport, Louisiana, Wednesday, December 12, 1945.

Court met pursuant to adjournment at 11 A. M.

Present: Hon. Ben C. Dawkins, Judge, presiding, and other Court Officials.

Ogilvie Hardware Company,
vs. No. 1256 Civil.
United States of America.

It was ordered by the Court that the Motion filed by the United States for a new trial be overruled.

Ordered that Court be adjourned.

JUDGMENT.

No. 1256.

(Titles Omitted.)

In this case, by reason of the law and evidence being in favor thereof, and for the reasons given in the written opinion herein filed,

It Is Ordered, Adjudged and Decreed that the plaintiff, Ogilvie Hardware Company, Inc., do have and recover judgment against the defendant, the United States of America, in the full sum of Six Thousand Nine Hundred Fifteen and 79/100 ($6,915.79) Dollars with interest there-

on at the rate of six per cent (6%) per annum calculated as follows:

On $ 609.40 from October 18th, 1938;
On $1,562.31 from January 13th, 1939;
On $1,562.31 from April 12th, 1939;
On $1,692.91 from July 14th, 1939;
On $ 202.58 from February 16th, 1939;
On $ 372.22 from May 15th, 1939;
On $ 914.06 from May 22nd, 1939.

This Done and Signed on this the 18th day of October, 1945.

BEN C. DAWKINS,
Judge, United States District Court, Western District of Louisiana, Shreveport Division.

Filed October 18, 1945. Philip H. Mecom, Clerk, U. S. District Court, West. Dist. of Louisiana.

NOTICE OF APPEAL.

In the United District Court for the Western District of La., Shreveport Division.

Ogilvie Hardware Company,
vs. Civil Action No. 1256.
United States of America.

Notice is hereby given that the United States of America, the above named defendant, hereby appeals to the United States Circuit Court of Appeals for the Fifth Circuit from

the final judgment entered in this action on October 18, 1945.

MALCOLM E. LAFARGUE,
(Malcolm E. Lafargue),
United States Attorney,
WILLIAM J. FLENIKEN,
(William J. Fleniken),
Assistant United States
Attorney.

U. S. District Court, Western District of Louisiana. Filed Jan. 17, 1946. Philip H. Mecom, Clerk, By ....., Deputy.

DESIGNATION OF RECORD.

In the District Court of the United States for the Western District of Louisiana, Shreveport Division.

Ogilvie Hardware Company, Inc.,
vs. Civil Action No. 1256.
United States of America.

Appellant designates the entire record to be contained in the record on appeal in this action.

MALCOLM E. LAFARGUE,
(Malcolm E. Lafargue),
United States Attorney,
WM. J. FLENIKEN,
(William J. Fleniken),
Assistant United States
Attorney.

I hereby certify that a copy of the above and foregoing designation has this day been mailed to Mr. Elias Gold-

stein, Attorney for Ogilvie Hardware Company, First National Bank Bldg., Shreveport, Louisiana.

WM. J. FLENIKEN.

U. S. District Court, Western District of Louisiana. Filed Feb. 4, 1946. Philip H. Mecom, Clerk, By ..... Deputy.

MOTION AND ORDER.

In the District Court of the United States for the Western District of Louisiana, Shreveport Division.

Ogilvie Hardware Company, Inc.,
vs. Civil Action No. 1256.
United States of America.

To the Honorable Judges of this Court:

Comes now the United States of America through Malcolm E. Lafargue, United States Attorney, and William J. Fleniken, Assistant United States Attorney, in the above entitled cause and respectfully shows:

1.

That the judgment was signed by the Honorable Court in the above entitled and numbered cause at Shreveport on October 18, 1945, and filed in the office of the Clerk of this Court at Shreveport on the same date;

2.

That on October 18, 1945, petition for rehearing was filed, and overruled on December 12, 1945;

3.

That on January 17, 1945, appellant filed notice of appeal to the United States Circuit Court of Appeals for the Fifth Circuit;

4.

That on February 1, 1946, appellant filed its designation of the record on appeal herein;

5.

That the Clerk will be unable to complete the preparation of the record on appeal within the statutory period of forty days from the filing of such notice of appeal, for the reason that other work and matters must first be attended to;

Wherefore, appellant moves the Court for an order extending the time within which the record on appeal herein may be filed and the appeal designated in the said United States Court of Appeals for the Fifth Circuit for the period of ninety days from date of filing of said notice of Appeal, January 17, 1946.

MALCOLM E. LAFARGUE,
(Malcolm E. Lafargue),
United States Attorney,
WILLIAM J. FLENIKEN,
(William J. Fleniken),
Assistant United States
Attorney.

ORDER.

The above and foregoing motion considered,

It Is Hereby Ordered that the period of time within which the record of appeal in the above entitled and numbered cause may be filed and the appeal designated in the United States Circuit Court of Appeals for the Fifth Circuit is hereby extended for the period of ninety days from January 17, 1946, date that the notice of Appeal was filed in said cause.

Thus Done and Signed this 5th day of February, 1946.

BEN C. DAWKINS,
Judge.

U. S. District Court, Western District of Louisiana. Filed Feb. 6, 1946. Philip H. Mecom, Clerk, By M. E. H., Deputy.

CLERK'S CERTIFICATE.

I, PHILIP H. MECOM, Clerk of the United States District Court for the Western District of Louisiana, do hereby certify that the foregoing twenty-eight (28) pages contain and form a full, true, correct and complete transcript of the record, and all proceedings had in a cause entitled Ogilvie Hardware Co., Inc. v. United States of America, No. 1256 on the Civil Docket of said Court, as fully as the original of same remains on file and of record in this office, at Shreveport, Louisiana, the said transcript having been prepared in accordance with Designation filed by counsel in said cause, a copy of which accompanies this transcript.

Witness my official hand and the seal of said Court, at the City of Shreveport, Louisiana, this the 22nd day of March, A. D. 1946.

PHILIP H. MECOM,
(Seal) Clerk,
By MINA E. HOLT,
Deputy Clerk.

Argument and submission

Extract From the Minutes of May 15th, 1946

No. 11609

UNITED STATES OF AMERICA

vs.

OGILVIE HARDWARE COMPANY, INC.

On this day this cause was called, and, after argument by Robert R. Reynolds, Jr., Esq., Special Assistant to the Attorney General, for appellant, and Elias Goldstein, Esq., for appellee, was submitted to the Court.

Opinion of the court

Filed May 24, 1946

In the United States Circuit Court of Appeals for the Fifth Circuit

No. 11609

UNITED STATES OF AMERICA, APPELLANT

vs.

OGILVIE HARDWARE COMPANY, INC., APPELLEE

Appeal from the District Court of the United States for the Western District of Louisiana

(May 24, 1946)

Before SIBLEY, HUTCHESON, and WALLER, Circuit Judges

SIBLEY, Circuit Judge: The suit in the district court was to recover undistributed profits taxes unlawfully exacted from Ogilvie Hardware Company for fiscal years ending May 31, 1937 and 1938. The unlawfulness of the exaction was asserted to arise out of the refusal to allow the credit provided by the Revenue Act of 1942 (56 Stats. 798), Section 501, which retroactively amended Section 26 of the Revenue Act of 1936. On stipulated facts the district court held the credit allowable, and gave judgment for the Company. The United States appeals.

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The important facts are that the Ogilvie Hardware Company was organized under the laws of Louisiana in 1907, and has since done business in that State. Originally its capital stock was 1,000 shares common stock, total par value being $100,000. In July 1924, having a surplus of $149,306, it paid a 100% dividend in common stock, $100,000, and also a cash dividend, both being charged out of the surplus and leaving $42,229 as surplus. In 1934 money had to be borrowed and $23,000 more preferred stock was issued as a bonus to the lender. On May 31, 1936, the taxpayer's books disclosed a deficit of $74,875. On May 31, 1937, the deficit was $71,347; and May 31, 1938, $60,923. It is stipulated that the sole question is whether the taxpayer can use the $100,000 common stock dividend and the $23,000 preferred stock bonus, as it did, in showing these deficits. In argument it is conceded that if the stock dividend of $100,000 is to be availed of, the preferred stock may be disregarded, because the deficits would exist without it. The district court, 62 Fed. Sup. 338, held that under the law of Louisiana the Company could not in the tax years pay out its current profits so long as the deficit existed, and that under the 1942 amendment it was entitled to the credit claimed, following Glenn, Collector, vs. Byron Sash and Door Co. (6 Cir.), 150 Fed. (2) 44; and distinguishing on its facts Century Electric Co. vs. Commission (9 Cir.), 144 Fed. (2) 983.

On reading the report of the last mentioned case in the Tax Court, 3 T. C. 297, we are not sure that the distinction exists which the Sixth Circuit Court in the Byron Sash and Door Company case thought existed, and which is indicated by the language of the opinion in the Century Electric Company case. We are therefore dealing with the question as we see it, rather than on authority.

By the Revenue Act of 1936, Section 14, a heavy surtax was laid on corporations on their "undistributed net income," the purpose being to force the payment of dividends so that the dividends might be taxed again as income to the shareholders. Section 26 (1) and (2), however, nullified the surtax by a credit to the extent that distribution of the corporate income was prevented by contracts executed prior to May 1, 1936. The Supreme Court held that this credit did not extend to any prevention except by contracts exactly as described in the Section, and that a prevention by the State law under which the corporation exists and acts was not enough. Helvering vs. Northwest Mills, 311 U. S. 46. Because of and to remedy this, the amendment of 1942 was made which retroactively controls here. The words to be construed, extending the cases of credits under Section 26, are: "3. Deficit Corporations. In the case of a corporation having a

deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936." Section 26 of the Louisiana Corporation Law (Louisiana Acts of 1928, p. 424) provides that no corporation shall pay dividends in cash or property "except from the surplus of the aggregate of its assets over the aggregate of its liabilities plus the amount of its capital stock," and expressly excludes from the surplus a number of unrealized values such as appreciation in real estate not sold, profits on notes purchased which have not accrued or been realized, and the like. It is plain that all the capital stock must be treated as a liability in determining whether there is a surplus of assets over liabilities out of which a cash dividend can be paid. If there is a deficit instead of a surplus no cash dividend is lawful. This law was in effect eight years before May 1, 1936. The district court rightly held that the increase in capital stock by the stock dividend in 1924, lawfully made, increased the capital stock of the Company, and the additional stock must be included with the other stock and liabilities in determining whether there was a dividend surplus, and that, there being no question about the aggregate of the assets, the State law prevented the payment of dividends in the tax years.

Turning to the words in the federal amendment, "A deficit in accumulated earnings and profits," they are not specially defined and ought to have their natural, common meaning. They occur twice in the single clause of the amendment. In the second occurrence the context is, "the corporation is prohibited by law from paying dividends during the existence of a deficit in accumulated earnings and profits." Clearly the deficit here referred to is that which the State law makes a deficit in prohibiting the payment of dividends. We see no propriety in constructing a different meaning in their first occurrence, "In the case of a corporation having a deficit in accumulated earnings and profits." It is he same corporation in the same condition that is referred to. A corporation which exists under Louisiana law and has a deficit and not a surplus under that law and is thereby prevented from paying dividends, is a corporation protected by the amendment. There is no justification for saying that in the last quoted phrase the deficit meant is that which may be figured by adding all the earnings and profits the corporation has made since its beginning and subtracting only what has been paid out in taxable dividends. The remedy expressed by the amendment is to give to prevention by a law made before May 1, 1936, the same

effect that prevention by a contract executed before that date is given in relieving from the surtax on nondistribution of current earnings and profits.

That divergent meanings be given the same words in the beginning and end of the same clause is said to be required because the Committee which recommended the amendment to the Senate, after stating the object of the amendment as we have just stated it, illustrated its operation by two examples, in the latter of which it was indicated that when "the deficit on the corporation's books was by reason of a prior capitalization of surplus in the course of a nontaxable reorganization" the deficit, so far as thus caused, would not be recognized though it might be by the State law. This example was copied into the Regulations also. It actually speaks only of reorganizations and not of stock dividends. We do not think the example is any part of the unambiguous Act of Congress. It is merely the opinion of the writer of the report on how the legislation would work out in the case of a nontaxable reorganization. The Constitution, Article 1, Section 7, states how the laws of the United States are made: by written Bill, passed by the House and Senate separately, transmitted to the President and approved by him, or passed over his veto. The provision is express that thus "the same [the Bill] shall be a Law". The report of a Committee of the Senate is not voted on—perhaps not read by—the members even of the Senate; but the words of the Bill are. The Bill is transmitted to the House, and it—not the Committee's report—is passed there. The Bill is then sent to the President for his approval. He does not approve a Committee report, if by any chance he should see it. He approves the words of the Bill and it becomes the law. Under the statutes on the subject the Bill as soon as passed by either House is printed and becomes the authentic Bill: 1 U. S. C. A. § 26. On final passage and printing, 44 U. S. C. A. § 196, the printed Acts are evidence of the laws passed; 1 U. S. C. A. § 30. The words of the Act are the law. Only when the words of the law are difficult of understanding can what happened in passing it be resorted to for aid. Its clear meaning cannot be so altered. Nor can anything be thus added to it. Nor can putting an example into the Regulation add to or change the law as passed.

So recourse is had to Section 115 (h) of the Revenue Act of 1936, in substance stating that a distribution by or on behalf of a corporation shall not be considered a distribution of earnings and profits of the corporation if no gain to such distributee was recognized by law or if the distribution was not subject to tax because it did not constitute income to him within the meaning of the Sixteenth Amendment. This Section has reference not to the taxes or credits of the corporation, but only to the taxation of the shareholder, as a reading of the whole Section will show. Subsection (h) means

that when the shareholder gets something in the way of a dividend which is not presently taxable, it will be held taxable as a dividend when the impediment is removed, or the value which he has received is finally realized. Thus in Eisner vs. McComber, 252 U. S. 189, a stock dividend, which is a capitalization of earnings and profits of the corporation, was held not presently taxable to the shareholder because he had not realized any gain; but when on the liquidation of the corporation, or by sale of his stock he does realize the gain, it is all then taxable to him as gain. We do not think this provision has any bearing on the 1942 amendment under discussion which relates to the taxation of the corporation itself for not distributing its current income.

If the deficit of this Company had been caused directly by a stock dividend, as the language of the court in Century Electric Co. vs. Commissioner, supra, indicates the court there thought, we might agree that the Company could not secure the credit by such an act. But the stock dividend here was lawfully accomplished in 1924, twelve years before this surtax on undistributed profits ever existed. Since 1924 this $100,000 has from the corporate standpoint been irrevocably taken out of distributable earnings and profits, or surplus, and has been capital, which could not according to the law recognized in Eisner vs. McComber, supra, and all the authorities, be distributed to shareholders unless on due proceedings to reduce the capital stock. There was then left a substantial surplus. This was lost and the deficit created in the depression years by operating losses. We hold this corporation was entitled to the credit against surtax in the tax years here involved, and the judgment is affirmed.

Teste:

Judgment

Extract from the Minutes of May 24th, 1946

No. 11609

UNITED STATES OF AMERICA

vs.

OGILVIE HARDWARE COMPANY, INC.

This cause came on to be heard on the transcript of the record from the District Court of the United States for the Western District of Louisiana, and was argued by counsel;

On consideration whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed.

Clerk's certificate

United States of America, United States Circuit Court of Appeals, Fifth Circuit

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 34 to 42 next preceding this certificate contain full, true and complete copies of all the pleadings, record entries and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said Court, numbered 11609, wherein United States of America is appellant, and Ogilvie Hardware Company, Inc., is appellee, as full, true and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 33 are identical with the printed record upon which said cause was heard and decided in the said Circuit Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said United States Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 26th day of July, A. D. 1946.

[SEAL]

(s) OAKLEY F. DODD,
Clerk of the United States Circuit Court of Appeals, Fifth Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1946

Supreme Court of the United States

No. 430 —, October Term, 1946

Order allowing certiorari

Filed October 14, 1946

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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U. S. GOVERNMENT PRINTING OFFICE 1946

FILE COPY

Office - Supreme Court, U. S.
FILED
AUG 22 1946
CHARLES ELMORE CROPLEY

No. 430

In the Supreme Court of the United States

OCTOBER TERM, 1946

UNITED STATES OF AMERICA, PETITIONER

v.

OGILVIE HARDWARE COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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CITATIONS

Cases:	
Century Electric Co. v. *Commissioner*, 144 F. 2d 983, affirming 3 T. C. 297	5, 6, 7, 10
Commissioner v. *Bedford, Estate of*, 325 U. S. 283	11
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Long v. *Commissioner*, decided May 11, 1942	11
United States v. *Byron Sash & Door Co.*, 150 F. 2d 44	11
Statutes:	
Louisiana Acts (1928) Act No. 250, Sec. 26	13
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 26	5, 6, 7, 12
Sec. 115	6, 7, 12
Miscellaneous:	
S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 244–246 (1942–2 Cum. Bull. 504, 682–684), Sec. 501	8, 17
Treasury Regulations 94, Art. 26–2	8, 15

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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

OGILVIE HARDWARE COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the United States of America, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit, entered May 24, 1946, affirming the judgment of the District Court of the United States for the Western District of Louisiana.

OPINIONS BELOW

The opinion of the District Court (R. 17–25) is reported in 62 F. Supp. 338. The opinion of the Circuit Court of Appeals (R. 34–38) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 24, 1946. (R. 38.) The

jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer is entitled to a credit under Section 26 (c) (3) of the Revenue Act of 1936, as added by Section 501 of the Revenue Act of 1942, as a corporation "having a deficit in accumulated earnings and profits," where there is in fact no deficit unless there be subtracted from its earnings and profits the amount of a non-taxable stock dividend which the taxpayer had previously issued.

STATUTES AND OTHER AUTHORITIES INVOLVED

The pertinent provisions of the statutes and other authorities involved are set out in the Appendix, *infra*, pp. 12–19.

STATEMENT

The facts as stipulated (R. 12–17) may be summarized as follows:

The taxpayer, Ogilvie Hardware Company, Inc., was incorporated under the laws of Louisiana in 1907, with a capital stock of 1,000 shares of common stock of the par value of $100,000 issued and outstanding. It operated a wholesale hardware business in that State on a fiscal year basis, ending on May 31, of each year. (R. 12–13.)

The surplus of the corporation at the end of the fiscal year, May 31, 1924, was $149,306.43. On July 7, 1924, a one hundred percent dividend in common stock ($100,000 par value) was issued, share for share, to its common stockholders, which was charged to surplus on the books of the taxpayer during the fiscal year 1925. After charging this dividend to surplus, payment of a cash dividend of $14,681, and giving effect to the earnings for the year ending May 31, 1924, the corporation still had a surplus of $42,229.70. (R. 13.)

Subsequent to the declaration of the stock dividend, the taxpayer sustained operating losses, and on May 31, 1936, its books disclosed a deficit of $74,875.10. On May 31, 1937, the deficit shown on the books was $71,347.18, and on May 31, 1938, the deficit shown was $60,923.58. (R. 14.)

Upon examination of the taxpayer's income and excess profits returns for the fiscal years ending May 31, 1937, and May 31, 1938, the Commissioner of Internal Revenue made certain adjustments and assessed additional taxes, which were paid by the taxpayer. Of the total taxes paid by the taxpayer for those periods, $5,426.93 consisted of a surtax on undistributed profits for the fiscal year 1937, and $1,488.86 consisted of a surtax on undistributed profits for the fiscal year 1938. (R. 15, 16.)

Following the enactment of Section 501 of the Revenue Act of 1942, the taxpayer filed claims for refund of the surtax on undistributed profits in the amounts of $5,426.93 and $1,488.86, for the fiscal years 1937 and 1938, respectively, based on the ground that it had a continuous "deficit" in accumulated earnings and profits on May 31, 1936, May 31, 1937, and May 31, 1938, which on each of those dates exceeded the total amount of its net income for the fiscal years ending with those dates and that it was thus prohibited by Louisiana law from paying dividends to its stockholders. The Commissioner rejected the claims and thereafter the present suit was instituted to recover these amounts. (R. 16–17.)

The District Court entered a judgment in favor of the taxpayer for the amount in suit (R. 27–28), and the Circuit Court of Appeals affirmed (R. 38).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that the taxpayer is entitled to a credit as a corporation having a deficit in accumulated earnings and profits within the meaning of Section 26 (c) (3) of the Revenue Act of 1936, as added by Section 501 of the Revenue Act of 1942.

(2) In holding that state law is controlling in the determination of whether a corporation is a

deficit corporation within the meaning of these provisions of the federal statute.

(3) In holding that the report of the Senate Committee on Finance may not be resorted to as an aid in interpreting the statute.

(4) In holding invalid the pertinent provision of the Treasury Regulations.

(5) In holding that the 1924 stock dividend irrevocably took $100,000 out of distributable earnings and profits, or surplus, and converted it to capital for federal tax purposes.

(6) In affirming the judgment of the District Court.

REASONS FOR GRANTING THE WRIT

1. The decision of the court below in the present case is in conflict with the decision of the Circuit Court of Appeals for the Eighth Circuit in *Century Electric Co.* v. *Commissioner,* 144 F. 2d 983, which affirmed a decision of the Tax Court reported in 3 T. C. 297.

In that case, as in the present case, the question was whether the taxpayer in computing the surtax upon undistributed profits was entitled to a credit under Section 26 (c) (3) of the Revenue Act of 1936, as added by Section 501 of the Revenue Act of 1942, Appendix, *infra,* p. 12, as a corporation having a deficit in its accumulated earnings and profits where the book deficit would

not have existed except for the prior issuance by the taxpayer of a nontaxable stock dividend.

Section 26 (c) (3), as amended, provides for a credit "In the case of a corporation having a deficit in accumulated earnings and profits" if the corporation is prohibited by local law from paying dividends "during the existence of a deficit in accumulated earnings and profits."

In *Century Electric Co.* v. *Commissioner, supra,* the taxpayer contended that the meaning of "a corporation having a deficit in accumulated earnings and profits" appearing in Section 26 (c) (3) should be determined by state law and that under the state law applicable in that case, the issuance of the stock dividends resulted in a capitalization of earnings and profits and thereby effected a reduction thereof in an amount equal to the par value of the stock issued as stock dividends. Both the Tax Court and the Circuit Court of Appeals held, however, that federal law rather than state law controlled in the determination of this question, and the conclusion was reached that Section 115 (h) of the Revenue Act of 1936, Appendix, *infra,* pp. 12–13, declaring the distribution of nontaxable stock dividends should not be considered a distribution of earnings or profits of any corporation, precluded the reduction of the earnings and profits of a corporation on account of such nontaxable stock dividend so as to create a deficit

under Section 26 (c) (3) for which credit is given by that section.

In the present case, the court below held that the deficit referred to in Section 26 (c) (3) is that which the state law denominates as a deficit in prohibiting the payment of dividends, and the court accordingly held that Section 115 (h) of the Revenue Act of 1936 has no bearing on Section 26 (c) (3), as amended. Resorting to state law nomenclature, the court below held that the $100,000 represented by the 1924 stock dividend was, from the corporate standpoint, irrevocably taken out of the surplus earnings and profits and converted to capital, that the deficit was thus caused by subsequent operating losses, and that the taxpayer was entitled to the claimed credit.

The court below, although apparently recognizing a conflict between its decision and that in *Century Electric Co.* v. *Commissioner* (R. 35), stated that it *might* agree (R. 38) that the taxpayer could not secure the credit if the deficit had been caused directly by a stock dividend. In the *Century Electric Co.* case, however, as in the present case, the taxpayer's books had a credit balance in the surplus account after declaration of the stock dividend. In both that case and the present case the deficit would exist only by treating the stock dividend as diminishing the accumulated earnings and profits. There is, we submit, no adequate ground for distinguishing that case

from the present case. Because of the conflict, this is clearly an appropriate decision for this Court to review.

2. In reaching the result it did, the court below rejected the applicable Treasury Regulations as well as an unambiguous report of the Senate Committee on Finance. Indeed, the opportunity for ambiguity had been virtually eliminated by an "example" in the committee report showing the operation of the statute (S. Rep. No. 1631, Appendix, *infra*, pp. 17–19):

> Assume in the above example[1] that the deficit in accumulated earnings and profits is $20,000 for income tax purposes, but the deficit in accumulated earnings and profits on the corporation's books by reason of a prior capitalization of surplus in the course of a nontaxable reorganization amounts to $250,000. In this case, although the State law would probably prohibit payment of any dividends, the credit allowed under the amendment to section 26 (c) is limited to $20,000, which is the deficit in accumulated earnings and profits for income tax purposes. X corporation, therefore, will be liable for undistributed profits surtax on $180,000 of its adjusted net income.

This example is also contained in Article 26–2 of Treasury Regulations 94, as amended (Appendix, *infra*, pp. 15–17).

---

[1] The "above example" referred to X corporation which had an adjusted net income of $200,000.

In refusing to give any weight to the example, the court employed a technique of statutory construction that is plainly at variance with the current of decision in this Court. Compare, e. g., *Harrison* v. *Northern Trust Co.*, 317 U. S. 476. The court below was at pains to point out the basis for disregarding the committee report and regulations in the following analysis of the legislative process (R. 37):

> It [the example] is merely the opinion of the writer of the report on how the legislation would work out in the case of a nontaxable reorganization. The Constitution, Article 1, Section 7, states how the laws of the United States are made: by written Bill, passed by the House and Senate separately, transmitted to the President and approved by him, or passed over his veto. The provision is express that thus "the same [the Bill] shall be a Law". The report of a Committee of the Senate is not voted on—perhaps not read by—the members even of the Senate; but the words of the Bill are. The Bill is transmitted to the House, and it—not the Committee's report—is passed there. The Bill is then sent to the President for his approval. He does not approve a Committee report, if by any chance he should see it. He approves the words of the Bill and it becomes the law. Under the statutes on the subject the Bill as soon as passed by either House is printed and becomes the authentic Bill: 1 U. S.

C. A. § 26. On final passage and printing, 44 U. S. C. A. § 196, the printed Acts are evidence of the laws passed; 1 U. S. C. A. § 30. The words of the Act are the law. Only when the words of the law are difficult of understanding can what happened in passing it be resorted to for aid. Its clear meaning cannot be so altered. Nor can anything be thus added to it. Nor can putting an example into the Regulation add to or change the law as passed.

It is a matter of general importance that the administration of the revenue laws be protected against judicial interference by means of such statutory construction, where the intent of Congress is so clearly set forth in the committee reports, where the Treasury regulations plainly establish the administrative practice, and where the Tax Court has approved that practice.[2]

3. Although the undistributed profits tax, here involved, has been repealed, the question presented is nevertheless very much alive in cases pending in the District Courts within the Third, Fifth, Sixth, Seventh and Tenth Circuits, involving substantial amounts of revenue. It is in the interest of consistent administration of the tax laws that the issue be authoritatively set at rest by this Court.

Upon somewhat different reasoning, the court below arrived at the same result here as was

[2] See *Century Electric Co.* v. *Commissioner*, 3 T. C. 297.

reached in *United States* v. *Byron Sash & Door Co.*, 150 F. 2d 44 (C. C. A. 6). The Government did not apply for certiorari in that case because of the small amount there involved and because it was hoped that other courts[2] would not follow it since it seemed so plainly wrong; and the latter reason seemed particularly cogent in view of this Court's treatment of a similar situation in *Commissioner* v. *Estate of Bedford*, 325 U. S. 283. However, the decision in the present case demonstrates that there is an irreconcilable conflict among the circuits, and it is in the public interest that the issue be settled.

CONCLUSION

For the reasons stated it is respectfully submitted that the petition for a writ of certiorari should be granted.

J. HOWARD MCGRATH,
Solicitor General.

AUGUST 1946.

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[2] See the later decision of the Sixth Circuit in *Long* v. *Commissioner*, decided May 11, 1946 (1946 C. C. H., par. 9271), for that court's views generally on the effect of the distribution of a nontaxable stock dividend.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) [As amended by Section 501 of the Revenue Act of 1942, c. 619, 56 Stat. 798.] *Restrictions on Payment of Dividends*—

* * * * *

(3) *Deficit corporations.*—In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936.

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * *

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a dis-

tribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

Louisiana Acts (1928), Act No. 250:

SECTION 26. DIVIDENDS: METHOD OF ESTIMATING FUND FOR PAYMENT OF.

I. No corporation shall pay dividends in cash or property,

(a) except from the surplus of the aggregate of its assets over the aggregate of its liabilities, plus the amount of its capital stock; or

(b) out of any surplus due or arising from—

(1) any profit on treasury shares before resale; or

(2) any unrealized appreciation in value or revaluation of fixed assets; or

(3) any unrealized appreciation in value or revaluation of inventories before sale; or

(4) the unaccrued portion of unrealized profit on notes, bonds or obligations for the payment of money, purchased or other-

wise acquired, unless such notes, bonds or obligations are readily marketable, in which case they may be taken at their actual market value; or

(5) the unaccrued or unearned portion of any unrealized profit in any form whatever, whether in the form of notes, bonds, obligations for the payment of money, installment sales, credits or otherwise, except as provided in the preceding subparagraph (4).

II. In case all or any part of any cash dividend is paid out of paid-in surplus, the shareholders shall at the time of payment be notified of that fact.

III. No corporation shall pay dividends in shares of the corporation, except from the surplus of the aggregate of its assets, which, for this purpose only, may include items mentioned in Subdivision I (b), over the aggregate of its liabilities, plus the amount of its capital stock.

IV. In computing the aggregate of the assets of the corporation, for the purpose of dividends, whether payable in cash, property or shares, proper allowance shall be made for depreciation and depletion sustained, and ascertained or known losses of every character. Deferred assets and prepaid expenses shall be considered as assets only to the amounts not used or not accrued.

V. Subject to the limitations contained in this Section, a dividend may be declared in shares of the corporation, whenever the board of directors so determine, provided that

(a) if the dividend is to be paid in shares having a par value, the aggregate par value of such shares shall not exceed the amount

of that portion of the corporation's surplus which is transferred to capital as payment for such shares;

(b) if the dividend is paid in shares having no par value, the number of such shares shall be fixed by the board of directors;

(c) no dividend payable in shares of any class shall be paid to shareholders of any other class, unless the articles so provide, or such payment is authorized by the vote of the holders of a majority of the shares of the class in which the payment is to be made.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26–2. [As amended by T. D. 5263, 1943 Cum. Bull. 1003.] *Credit in Connection With Restrictions on Payment of Dividends.*—

* * * * *

(d) ***Deficit corporations.***—Under the provisions of section 26 (c) (3), a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year is allowed as a credit the amount of such deficit to the extent that the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936.

Whether such a deficit exists as of the close of the preceding taxable year is a question to be determined from the facts and circumstances of each particular case. In any such case the taxpayer must show

how the deficit arose, whether from operating losses, capital distributions in excess of earnings and profits, or other causes. In addition the taxpayer must show, under a law or an order of a public regulatory body, the extent to which it could not legally have paid dividends during the existence of such deficit. A State law, for example, might permit the payment of a dividend from unrealized appreciation in value of assets even though the corporation had a deficit in accumulated earnings and profits. A deficit in accumulated earnings and profits can arise only out of the operation of the business at a loss and can not be caused by distributions to shareholders in excess of the amount of accumulated earnings and profits. If distributions are made to shareholders out of accumulated earnings and profits, however, such distributions may contribute to the creation of a deficit by so exhausting the accumulated earnings and profits that they are incapable of absorbing a loss thereafter resulting from the business. Unrealized appreciation or depreciation in value of assets is not a factor in determining accumulated earnings and profits.

The application of the provisions of section 26 (c) (3) may be illustrated by the following examples:

Example (1).—The M Corporation for the calendar year 1936 had an adjusted net income of $200,000 but had an actual deficit in accumulated earnings and profits as of December 31, 1935, of $20,000. By reason of a State law in effect prior to May 1, 1936, with respect to deficit corporations, the M Corporation was prohibited from paying dividends during the existence of

such deficit. Under section 26 (c) (3), the M Corporation is allowed a credit of $20,000.

Example (2).—Assume in the above example that the deficit in the accumulated earnings and profits is $20,000 for income tax purposes, but the deficit on the corporation's books by reason of a priof capitalization of surplus in the course of a nontaxable reorganization amounts to $250,000. In this case, even though the State law might prevent the distribution of any dividends, the credit under section 26 (c) (3) is limited to $20,000, which is the deficit in accumulated earnings and profits for income tax purposes.

* * * * * * *

S. Rep. 1631, 77th Cong., 2d Sess., pp. 244–246 (1942–2 Cum. Bull. 504, 683–684):

SECTION 501. ADDITIONAL CREDITS FOR UNDISTRIBUTED PROFITS TAX.

This section is the same as in the House bill, except that a new paragraph to section 26 (c) has been added, providing for an additional credit in cases of corporations having a deficit in accumulated earnings and profits and prohibited by law from paying dividends, and except that a new subsection has been added providing for a stock redemption credit.

* * * * * *

Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax at various rates from 7 to 27 percent of their undistributed net income. In some instances State law or an order of a public regulatory body prohibited payment of dividends during the existence of a deficit even though the corporation had cur-

rent earnings and profits which would constitute undistributed net income under the definition thereof in section 14 (a) (2). Such corporations were, therefore, subject to undistributed profits surtax even though they were prohibited by law from paying dividends. The addition of the new paragraph 3 to subsection (c) of section 26 to provide an additional credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year is intended to give relief in certain of these cases.

* * * * * *

The application of the deficit credits provided by these amendments may be illustrated by the following examples:

(1). The X corporation for the calendar year 1936 had an adjusted net income of $200,000 but had a deficit in accumulated earnings and profits as of the close of the preceding calendar year of $20,000. By reason of a State law in effect prior to May 1, 1936. with respect to deficit corporations, only $180,000 of this adjusted net income could be distributed as dividends. Under section 14 of the Revenue Act of 1936, X corporation would be subject to undistributed-profits surtax on $20,000 even though it paid out the entire amount which it could have distributed without violating the State law—namely, $180,000, as taxable dividends. Under the amendment to section 26 (c), X corporation would be allowed a credit of $20,000, and would not be liable for any undistributed-profits tax for the calendar year 1936.

(2) Assume in the above example that the deficit in accumulated earnings and profits is $20,000 for income tax purposes,

but the deficit in accumulated earnings and profits on the corporation's books by reason of a prior capitalization of surplus in the course of a nontaxable reorganization amounts to $250,000. In this case, although the State law would probably prohibit payment of any dividends, the credit allowed under the amendment to section 26 (c) is limited to $20,000, which is the deficit in accumulated earnings and profits for income tax purposes. X corporation, therefore, will be liable for undistributed profits surtax on $180,000 of its adjusted net income.

* * * * *

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No. 430

In the Supreme Court of the United States

OCTOBER TERM, 1946

UNITED STATES OF AMERICA, PETITIONER

v.

OGILVIE HARDWARE COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES.

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OPINIONS BELOW

The opinion of the district court (R. 17–25) is reported in 62 F. Supp. 338. The opinion of the circuit court of appeals (R. 34–38) is reported in 155 F. 2d 577.

JURISDICTION

The judgment of the circuit court of appeals was entered on May 24, 1946 (R. 38). The petition for a writ of certiorari was filed on August 22, 1946, and was granted on October 14, 1946 (R. 40). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer is entitled to a credit under Section 26 (c), (3) of the Revenue Act of 1936, as added by Section 501 of the Revenue Act of 1942, as a corporation "having a deficit in accumulated earnings and profits", where there is in fact no deficit unless there be subtracted from its earnings and profits the amount of a nontaxable stock dividend which the taxpayer had previously issued.

STATUTES AND OTHER AUTHORITIES INVOLVED

The pertinent provisions of the statutes and other authorities involved are set forth in the Appendix, *infra*, pp. 39-49.

STATEMENT

The facts, as stipulated (R. 12–17), may be summarized as follows:

The taxpayer, Ogilvie Hardware Company, Inc., was incorporated under the laws of Louisiana in 1907, with a capital stock of 1,000 shares of common stock of the par value of $100,000 issued and outstanding. It operated a wholesale hardware business in that State on a fiscal year basis, ending on May 31st of each year. (R. 12–13.)

The surplus of the corporation at the end of the fiscal year ending on May 31, 1924, was $149,306.43. On July 7, 1924, a one hundred percent dividend in common stock ($100,000 par

value) was issued, share for share, to its common stockholders, which was charged to surplus on the books of the taxpayer during the fiscal year 1925. After charging this dividend to surplus, paying a cash dividend of $14,681, and giving effect to the earnings for the year ending May 31, 1924, the corporation still had a surplus of $42,229.70. (R. 13.)

Subsequent to the declaration of the stock dividend, the taxpayer sustained operating losses, and on May 31, 1936, its books disclosed a deficit of $74,875.10. On May 31, 1937, the deficit shown on the books was $71,347.18, and on May 31, 1938, the deficit shown was $60,923.58. (R. 14.)

Upon examination of the taxpayer's income and excess profits returns for the fiscal years ending May 31, 1937, and May 31, 1938, the Commissioner of Internal Revenue made certain adjustments and assessed additional taxes, which were paid by the taxpayer. Of the total taxes paid by the taxpayer for those periods, $5,426.93 consisted of a surtax on undistributed profits for the fiscal year 1937, and $1,488.86 consisted of a surtax on undistributed profits for the fiscal year 1938. (R. 15, 16.)

Following the enactment of Section 501 of the Revenue Act of 1942, the taxpayer filed claims for refund of the surtax on undistributed profits in the amounts of $5,426.93 and $1,488.86, for the fiscal years 1937 and 1938, respectively, based

on the ground that it had a continuous "deficit" in accumulated earnings and profits on May 31, 1936, May 31, 1937, and May 31, 1938, which, on each of those dates, exceeded the total amount of its net income for the fiscal years ending with those dates, and that it was thus prohibited by Louisiana law from paying dividends to its stockholders. The Commissioner rejected the claims and thereafter the present suit was instituted to recover these amounts. (R. 16–17.)

The district court entered a judgment in favor of the taxpayer for the amount in suit (R. 27–28), and the circuit court of appeals affirmed (R. 38).

SPECIFICATIONS OF ERRORS TO BE URGED

The circuit court of appeals erred:

1. In holding that the taxpayer is entitled to a credit as a corporation having a deficit in accumulated earnings and profits within the meaning of Section 26 (c) (3) of the Revenue Act of 1936, as amended by Section 501 of the Revenue Act of 1942.

2. In holding that the state law is controlling in the determination of whether a corporation is a deficit corporation within the meaning of these provisions of the federal statute.

3. In holding that the report of the Senate Committee on Finance may not be resorted to as an aid in interpreting the statute.

4. In holding invalid the pertinent provision of the Treasury Regulations.

5. In holding that the 1924 stock dividend irrevocably took $100,000 out of distributable earnings and profits, or surplus, and converted it to capital for federal tax purposes.

6. In affirming the judgment of the district court.

SUMMARY OF ARGUMENT

I

The crucial words in Section 26 (c) (3) of the Revenue Act of 1936, so far as this case is concerned, are the words "deficit in accumulated earnings and profits". Neither the term "earnings and profits" nor the phrase "deficit in accumulated earnings and profits" is new to the federal tax law, and Congress, in Section 26 (c) (3), legislated in the light of the history of these terms and the special meaning they have acquired for federal tax purposes.

Under the federal revenue laws, the distribution of a nontaxable stock dividend cannot diminish the earnings and profits of a corporation. Such earnings and profits remain intact in the hands of the corporation available for future distribution as dividends. This principle has long been settled by judicial decision and has been clarified and enacted into statutory form by Congress in Section 115 (h) of the Revenue Act of 1936. The basic theory is that where a transaction is not recognized as a taxable distribution of earnings and profits it should not be recognized,

under the federal tax laws, as diminishing the amount of earnings and profits available for future distribution. Cf. *Commissioner* v. *Wheeler*, 324 U. S. 542, 546–547. And this Court has recognized that the distribution of a nontaxable stock dividend does not, for federal tax purposes, take the amount of such dividend out of distributable earnings and profits, or surplus, and convert it to capital. *Commissioner* v. *Estate of Bedford*, 325 U. S. 283. Hence, such a distribution cannot contribute to a "deficit in accumulated earnings and profits" within the meaning of Section 26 (c) (3).

That this is true is conclusively shown by the legislative history of Section 26 (c) (3). But the court below refused to consider an unambiguous report of the Senate Committee on Finance which set out an example of the statute's operation within which the present case fits, on the ground that the language of Section 26 (c) (3) was too clear to permit of outside aids to construction. In thus refusing to give any weight to the report of the Committee of Congress which proposed Section 26 (c) (3), the court below employed a technique of statutory construction that is plainly at variance with the current of decision in this Court.

Finally, the applicable Treasury Regulation reflects a view wholly inconsistent with that taken by the court below. This regulation has been up-

held by the Tax Court, and represents, at the minimum, a permissible construction on a doubtful point by the officials charged with administering the law. As such, it should not be invalidated.

II

The decision of the court below, holding that because the taxpayer corporation had "a deficit and not a surplus" under Louisiana law, it is entitled to the credit under Section 26 (c) (3), is justified neither by the words of the statute nor by the Congressional purpose in enacting the Section.

There is nothing in the language of the statute requiring the inference that the term "deficit in accumulated earnings and profits" be read in any but the federal tax sense. Under the statute, the credit is available only (1) when the corporation has a "deficit in accumulated earnings and profits" in the federal tax sense, (2) when the corporation is "prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence" of such a deficit, and (3) when such provision was in effect prior to May 1, 1936. In applying these provisions, it is necessary to determine, first, whether there is a "deficit in accumulated earning and profits" in the federal tax sense; only when such a determination is made is it relevant to inquire whether state law forbids the payment

of dividends. The error of the court below was in applying state law criteria to the resolution of the first question.

Congress did not intend, by means of Section 26 (c) (3), to grant a credit to every corporation forbidden to pay dividends. The related provisions of Section 26 plainly do not grant the credit simply because of a ban on the payment of dividends; and subsection (c) (3), similarly, is limited in scope.

It cannot be supposed that Congress intended, by implication, to import state law concepts into Section 26 (c) (3)'s definition of "deficit in accumulated earnings and profits." This term has never acquired a fixed meaning either in corporate finance and accounting or for purposes of state or other regulatory laws. Where resort to local law is to be had, Congress has expressly provided for it by making the credit available only if there is a prohibition of law against the payment of dividends by a corporation which has already established that it has a "deficit in accumulated earnings and profits".

In the absence of express language or a necessary implication that local law was to play a greater part than that thus assigned to it, Section 26 (c) (3) should be construed in the light of the general Congressional purpose to establish a nation-wide scheme of taxation uniform in its application.

ARGUMENT

I

THE TAXPAYER DID NOT HAVE "A DEFICIT IN ACCUMULATED EARNINGS AND PROFITS" WITHIN THE MEANING OF SECTION 26 (C) (3) OF THE REVENUE ACT OF 1936

The taxpayer, in the computation of the surtax imposed by Section 14[1] of the Revenue Act of 1936 on its undistributed profits for the fiscal years ending in 1937 and 1938,[1] claims the amount of the deficit shown on its books in its surplus account on May 31, 1936, and on May 31, 1937, respectively, as a credit under Section 26 (c) (3) of the Revenue Act of 1936, as added by Section 501 of the Revenue Act of 1942 (Appendix,

[1] Section 14 (Appendix, *infra*, p. 39) imposed a graduated surtax upon the "undistributed net income" of corporations in excess of certain percentages of the "adjusted net income". The term "adjusted net income" was defined in that Section to mean the "net income" minus the sum of the normal tax imposed by Section 13 and the credit provided in Section 26 (a) relating to interest on certain obligations of the United States and government corporations. The term "undistributed net income" was defined as the adjusted net income minus the sum of the dividends paid credit provided in Section 27 and the credit provided in Section 26 (c), relating to contracts restricting dividends. This definition of "undistributed net income" was changed by a retroactive amendment to the Section made by Section 501 of the Revenue Act of 1942, c. 619, 56 Stat. 798, to provide for the allowance of certain other credits embraced within other amendments made by Section 501 of the Revenue Act of 1942, one of which amendments added Section 26 (c) (3) here involved.

infra, p. 41). It does so on the ground that it was, within the meaning of that Section, a corporation "having a deficit in accumulated earnings and profits as of the close of the preceding taxable year" which was prohibited by a provision of state law, in effect prior to May 1, 1936, "from paying dividends during the existence of a deficit in accumulated earnings and profits".

The only question presented is whether the amount of the nontaxable stock dividend issued by the taxpayer in 1924 ($100,000) may be subtracted from the taxpayer's accumulated earnings and profits in determining whether the taxpayer is a corporation "having a deficit in accumulated earnings and profits" within the meaning of Section 26 (c) (3).[2] If the $100,000 represented by the 1924 stock dividend charged on the taxpayer's books against its surplus account be treated as not having diminished the taxpayer's accumulated earnings and profits for purposes of determining whether the taxpayer is a deficit

[2] The petition for certiorari raised no question with respect to the holding below that taxpayer was prohibited by the law of Louisiana from paying dividends during the fiscal years ending in 1937 and 1938. And the taxpayer has not attempted to controvert the position of the Government that the 1924 stock dividend was a nontaxable dividend. The district court held (R. 21) that the 1924 dividend was nontaxable both under Section 201 (f) of the Revenue Act of 1924, c. 234, 43 Stat. 253, and under the decisions of this Court. Its decision in this respect is in accord with *Eisner* v. *Macomber*, 252 U. S. 189, and *Helvering* v. *Griffiths*, 318 U. S. 371.

corporation within the meaning of Section 26 (c) (3), then it may not be denied that the taxpayer had in the tax sense no deficit, but rather a surplus in its accumulated earnings and profits on each of the critical dates.

A. *The term "deficit in accumulated earnings and profits" has acquired a special meaning for federal tax purposes.*—That the term "earnings and profits" has a special meaning in the federal tax sense is no longer open to doubt. This Court specifically so held in *Commissioner* v. *Wheeler*, 324 U. S. 542, 546, and the same conclusion is implicit in the decisions in *Commissioner* v. *Fisher*, 327 U. S. 512, and *Commissioner* v. *Estate of Bedford*, 325 U. S. 283. The phrase "earnings and profits" has a long history in the federal statutes, and in the absence of compelling evidence to the contrary it must be assumed that Congress legislated in the light of that history. Cf. *Estate of Sanford* v. *Commissioner*, 308 U. S. 39, rehearing denied, 308 U. S. 637. In all Revenue Acts beginning with that of 1916, the term has been used in defining "dividend" as meaning any distribution made by a corporation to its stockholders out of its "earnings or profits" accumulated after February 28, 1913.[3] The phrase "earnings and profits" appears as well in numer-

[3] Section 2 (a) of the Revenue Act of 1916, c. 463, 39 Stat. 756; Section 201 (a) of the Revenue Act of 1918 through 1926; and Section 115 (a) of subsequent Acts and the Internal Revenue Code.

ous other sections of the Revenue Acts. For example, see the Revenue Act of 1936, Sections 26 (c) (2), and (e), 27 (f), 102 (a), 112 (c) (2), 115 (a), (b), (c), (e), (g) and (h), and 351. And the phrase "deficit in the accumulated earnings and profits" is used in Section 27 (a) (3) of the Revenue Act of 1938, c. 289, 52 Stat. 447.[4]

While the term "earnings and profits"[2] has never been comprehensively defined in the federal statutes, its meaning has frequently been a matter of consideration for the administrative authorities and the courts. The meaning of the term, in certain of its aspects, has been crystallized in regulations of the Treasury Department and in court decisions, and Congress has enacted statutes to clarify and to put into statutory form some of the conclusions of the administrative and judicial branches as to the meaning of the term in the tax sense. Thus, in Section 501 of the Second Revenue Act of 1940, 54 Stat. 974, which antedated Section 26 (c) (3) here involved by approximately two years, and which came before this Court in *Commissioner* v. *Wheeler* referred to *supra*, p. 11, Congress adopted a clarifying amendment with

[4] In *Chapman Price Steel Co.* v. *Commissioner*, 146 F. 2d 189 (C. C. A. 7), certiorari denied, 325 U. S. 876, it was held that the issuance of a nontaxable stock dividend would not result in the depletion of the corporation's earned surplus so as to create a "deficit in accumulated earnings and profits" within the meaning of Section 27 (a) (3) of the Revenue Act of 1938. The reference in the opinion to the Revenue Act of 1936 seems to be a typographical error.

respect to the effect of gain or loss realized but not recognized under the revenue laws and the effect of the receipt of certain tax-free distributions on "earnings and profits". In view of the antecedent history of the use of the term "earnings and profits" and the term "deficit in earnings and profits" in the federal tax statutes, it must be assumed that Congress intended, in that portion of Section 501 of the Revenue Act of 1942, which added Section 26 (c) (3) to the Revenue Act of 1936, to use the terms in a sense no different from that in which they were used in other provisions of the tax statutes.

What we are particularly concerned with here, of course, is the effect on "earnings and profits" of the distribution of a nontaxable stock dividend. Congress has not left that question at large in the revenue laws. Even prior to the development in the case of *Commissioner* v. *Sansome*, 60 F. 2d 931 (C. C. A. 2), certiorari denied, 287 U. S. 667, of the principle that what is not "recognized" under the Revenue Acts as a sale or disposition for the purpose of fixing gain or loss should not be "recognized" as changing accumulated profits into capital, there had developed the principle that a nontaxable stock dividend does not effect a distribution of the earnings and profits of the corporation issuing such dividend but, rather, that these accumulations remain untouched and are available for future distribution.

Walker v. *Hopkins*, 12 F. 2d 262, 263 (C. C. A. 5), certiorari denied, 271 U. S. 687; *Wilson* v. *Commissioner*, 3 B. T. A. 957; *Kennish* v. *Commissioner*, 4 B. T. A. 303; *Megrath* v. *Commissioner*, 5 B. T. A. 1274, 1284; *Hedrick* v. *Commissioner*, 24 B. T. A. 444; *Untermyer* v. *Commissioner*, 24 B. T. A. 906, affirmed, 59 F. 2d 1004 (C. C. A. 2), certiorari denied, 287 U. S. 647; *McCulloch* v. *Commissioner*, 29 B. T. A. 67; *McCord* v *Commissioner*, 31 B. T. A. 342; *Horrmann* v. *Commissioner*, 34 B. T. A. 1178. See also *Noldè* v. *United States*, 64 C Cls. 204, certiorari denied, 276 U. S. 634.

The principle of the *Sansome* case and the principle that a nontaxable stock dividend does not diminish a corporation's accumulated earnings and profits were both approved by Congress and, in the interest of greater clarity, were put into statutory form in Section 115 (h) of the Revenue Act of 1936 (Appendix, *infra*, p. 43). That Section provides as follows:

> (h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—
>
> (1) if no gain to such distributee from

the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee, because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

The purpose of Congress in enacting Section 115(h) is set forth clearly in S. Rep. No. 2156, 74th Cong., 2d Sess., p. 19 (1939–1 Cum. Bull. (Part 2) 678, 690).[5] There can be no doubt from

[5] The Committee stated:

Section 115 (h). *Effect of Distributions on Earnings and Profits.*

The rule, under existing law, with respect to the effect on corporate earnings or profits of a distribution which, under the applicable tax law, is a nontaxable stock dividend or a distribution of stock or securities in connection with a reorganization or other exchange, on which gain is not recognized in full, is that such earnings or profits are not diminished by such distribution. In such cases, earnings or profits remain intact and hence available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange. This rule is stated only in part in section 115 (h) of the Revenue Act of 1934, and corresponding provisions of prior Acts, but is the rule which is applied by the Treasury and supported by the courts in *Commissioner* v. *Sansome* (60 Fed. (2d), 931); *United States* v. *Kauffman* (62 Fed. (2d), 1045);

the language of Section 115 (h) and the explanation of that Section in the Senate Committee Report that a nontaxable stock dividend is deemed not to diminish the earnings and profits of a corporation but that such earnings and profits remain intact and hence available for future distribution. The subdivision does not state that earnings and profits are not reduced by such stock dividends for certain purposes only, and its applicability is not limited to particular sections of the Revenue Act. In that respect it is like Section 115 (a). See *Commissioner* v. *Estate of Bedford*, 325 U. S. 283.

Subsequent to the enactment of the Revenue Act of 1936, the Treasury Regulations have consistently applied the rule that distributions of nontaxable stock dividends do not diminish earnings and profits for any purpose. Treasury Regulations 94 and 101, Article 115–11; Treasury Regulations 103, Section 19.115–11, and Treasury Regulations 111, Section 29.115–11. And decisions of the courts have, with few exceptions, recognized and applied the rule. *Long* v. *Commissioner*, 155 F. 2d 847 (C. C. A. 6th); *Chapman Price Steel Co.* v. *Commissioner*, 146 F. 2d 189 (C. C. A. 7), certiorari denied, 325 U. S. 876; *Beretta* v. *Commissioner*, 141 F. 2d 452

Murcheson v. *Comm.* (76 Fed. (2d), 641). While making no change in the rule as applied under existing law, the recommended amendment is desirable in the interest of greater clarity.

(C. C. A. 5), certiorari denied, 323 U. S. 720; *Van Norman Co.* v. *Welch*, 141 F. 2d 99, 102 (C. C. A. 1).

B. *The distribution of a nontaxable stock dividend cannot contribute to the creation of a "deficit in accumulated earnings and profits" under Section 26 (c) (3).*—Section 26 (c) (3), as retroactively added by Section 501 of the Revenue Act of 1942, provides that in the case of a corporation a credit shall be allowed as follows:

> (3) *Deficit Corporations.*—In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936.

Properly read, the provisions of Section 26 (c) (3) will be seen to fall into three parts, and it is clear that the taxpayer must show that he has satisfied each of the three requirements thus stated in order to be entitled to the credit granted by the Section. The first part of the Section, which reads "In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit", constitutes the grant of

the allowance. Such grant, however, is upon two further conditions which are expressed in the latter part of the Section: (1) "if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits", and (2) "if such provision was in effect prior to May 1, 1936."[6] Literal compliance with the terms of the statute is required. The statute grants a credit in the "nature of a specially permitted deduction", and should be strictly construed. *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 49; *Sumter Farm & Stock Co.* v. *United States*, 151 F. 2d 975 (C. C. A. 5). We think it plain that the term "deficit in accumulated earnings and profits", so construed, carries with it the federal tax concept, outlined above, *supra*, pp. 13–17, that the distribution of a nontaxable stock dividend cannot contribute to the creation of such a deficit.

This textual analysis of the terms of Section 26.(c) (3), as requiring that there be a "deficit in accumulated earnings and profits" in the

[6] The first of these two conditions was inserted in the statute apparently in recognition of the fact that under local law in some States, corporations may pay dividends notwithstanding the existence of a deficit in its earnings and profits. See, e. g., *Sumter Farm & Stock Co.* v. *United States*, 151 F. 2d 975 (C. C. A. 5). The second condition was undoubtedly included in the statute to preclude a circumvention of the intent of Congress by subsequently enacted local laws.

federal tax sense, is confirmed not only by the fact as shown above (*supra*, pp. 11–17), that the term has a special meaning for tax purposes, but also by the legislative history of Section 26 (c) (3) itself. The relevant legislative material conclusively demonstrates that the distribution of a nontaxable stock dividend does not affect the amount of accumulated earnings and profits. The intent of Congress in the enactment of Section 501 of the Revenue Act of 1942, which added Section 26 (c) (3) to the Revenue Act of 1936, was clearly set forth in a report of the Senate Committee on Finance in which any opportunity for ambiguity was virtually eliminated by an example showing the operation of the statute as follows (S. Rep. No. 1631, Appendix, *infra*, pp. 47–49):

> Assume in the above example[7] that the deficit in accumulated earnings and profits is $20,000 for income tax purposes, but the deficit in accumulated earnings and profits on the corporation's books by reason of a prior capitalization of surplus in the course of a nontaxable reorganization amounts to $250,000. In this case, although the State law would probably prohibit payment of any dividends, the credit allowed under the amendment to section 26 (c) is limited to $20,000, which is the deficit in accumulated earnings and profits for income tax pur-

[7] The "above example" referred to X corporation which had an adjusted net income of $200,000.

poses. X corporation, therefore, will be liable for undistributed profits surtax on $180,000 of its adjusted net income.

The conclusion is inevitable, from the explanation contained in the Senate Committee report, that the intention of Congress was that a deficit in earnings and profits within the meaning of Section 26 (c) (3) would not exist by virtue of the fact that in computing its book deficit, a corporation treated an earlier nontaxable stock dividend as diminishing "earnings and profits". While it is true that the example refers to a nontaxable reorganization, the same principle is applicable in determining the effect on earnings and profits of a nontaxable stock dividend as in determining the effect of a nontaxable reorganization on such earnings and profits. The example draws a distinction between a deficit in accumulated earnings and profits "for income tax purposes" and the deficit in accumulated earnings and profits on the corporation's books "by reason of a prior capitalization of surplus" in the course of a nontaxable reorganization, and states that although the state law would probably prohibit payment of any dividends, the credit allowed under the amendment to Section 26 (c) is limited to the "deficit" in accumulated earnings and profits for income tax purposes.

The intention of Congress is confirmed by reference to H. Rep. No. 2894, 76th Cong., 3d Sess.,

p. 41 (1940–2 Cum. Bull. 496, 526–527) dealing with Section 401 of the Second Revenue Bill of 1940 [Section 501 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974], which inserted the new subsection (l) in Section 115 of the Internal Revenue Code and correspondingly amended prior Revenue Acts.[8] This report was cited by this Court in *Commissioner* v. *Wheeler*, 324 U. S. 542, with approval. The report shows clearly that while Congress was, in that Section, clarifying the law with respect to what constitutes earnings and profits of a corporation, it intended that rule to be taken in conjunction with Section 115

[8] H. Rep. No. 2894, p. 41 reads in part as follows:

Section 401. Earnings and profits of corporations.

"The purpose of this amendment is to clarify the law with respect to what constitutes earnings and profits of a corporation. This is important not only for the purpose of determining whether distributions are taxable dividends but also in determining equity invested capital for excess-profits-tax purposes.

Section 401 of the Bill inserts subsection (l) in section 115 of the Internal Revenue Code and correspondingly amends prior revenue acts. The rule, applied by the Treasury under existing law, is that while gains or losses which are not recognized by reason of the provisions of section 112 neither increase nor diminish the earnings or profits, the earnings or profits are increased or diminished by the entire amount of the recognized gain or loss, computed in accordance with the provisions of sections 111, 112, and 113. Together with the provisions of section 115 (h) of the Internal Revenue Code, and the principles established in *Commissioner* v. *Sansome*, 60 F. (2d) 931, and following decisions, the rule effectuates the provisions of section 112. * * *"

(h) of the Revenue Act of 1936 and the principles of *Commissioner* v. *Sansome*, 60 F. 2d 931 (C. C. A. 2), certiorari denied, 287 U. S. 667, and the decisions which followed that case.

The court below refused to give any weight to S. Rep. No. 1631, explaining the new Section 26 (c) (3), on the ground that the meaning of Section 26 (c) (3) was too clear to permit of reference to outside aids to construction, although the court itself adverted to (R. 35), and was seemingly influenced by, what it considered to have been the purpose of Congress in enacting that Section, and although the Tax Court and the Circuit Court of Appeals for the Eighth Circuit in *Century Electric Co.* v. *Commissioner*, 3 T. C. 297, affirmed, 144 F. 2d 983, referred to in the opinion below, had both reached a conclusion as to the meaning of Section 26 (c) (3) contrary to that of the court below. The court pointed out its basis for disregarding the committee report and the regulations in the following analysis of the legislative process (R. 37):

> It [the example] is merely the opinion of the writer of the report on how the legislation would work out in the case of a nontaxable reorganization. The Constitution, Article 1, Section 7, states how the laws of the United States are made: by written Bill, passed by the House and Senate separately, transmitted to the President and approved by him, or passed over his veto.

> The provision is express that thus "the same [the Bill] shall be a Law." The report of a Committee of the Senate is not voted on—perhaps not read by—the members even of the Senate; but the words of the Bill are. The Bill is transmitted to the House, and it—not the Committee's report—is passed there. The Bill is then sent to the President for his approval. He does not approve a Committee report, if by any chance he should see it. He approves the words of the Bill and it becomes the law. Under the statutes on the subject the Bill as soon as passed by either House is printed and becomes the authentic Bill: 1 U. S. C. A. § 26. On final passage and printing, 44 U. S. C. A. § 196, the printed Acts are evidence of the laws passed; 1 U. S. C. A. § 30. The words of the Act are the law. Only when the words of the law are difficult of understanding can what happened in passing it be resorted to for aid. Its clear meaning cannot be so altered. Nor can anything be thus added to it. Nor can putting an example into the Regulation add to or change the law as passed.

This technique of statutory construction is, we submit, plainly at variance with the current of decision in this Court. In *Harrison* v. *Northern Trust Co.*, 317 U. S. 476, this Court said (p. 479):

> But words are inexact tools at best, and for that reason there is wisely no rule of law forbidding resort to explanatory legislative history no matter how "clear the

words may appear on 'superficial examination' ".

The same view was expressed in *United States* v. *Amer. Trucking Ass'ns,* 310 U. S. 535, 543–544, and in *United States* v. *Dickerson,* 310 U. S. 554, 561–562. If the proper consideration and weight be given to the legislative history of Section 26 (c) (3), the conclusion is compelled that the taxpayer is not entitled to a credit as a deficit corporation under that Section.

As has already been indicated, the Tax Court and the Circuit Court of Appeals for the Eighth Circuit, in *Century Electric Co.* v. *Commissioner,* 3 T. C. 297, affirmed, 144 F. 2d 983, concurred in holding that the meaning of "a corporation having a deficit in accumulated earnings and profits" as used in Section 26 (c) (3), here involved, is controlled by the federal rule, and that Section 115 (l) of the Revenue Act of 1936 is applicable and precludes the reduction of the earnings and profits of a corporation on account of nontaxable stock dividends for purposes of computing a deficit under Section 26 (c) (3) for which credit is given by that Section.[9]

[9] The taxpayer attempts to distinguish the *Century Electric Co.* case (Br. in Opp., pp. 6–8), contending that the stock dividends were declared by the corporation during the years 1936 and 1937, which were the tax years there involved. The Tax Court in that case did not find that the stock dividends were distributed in 1936 and 1937, nor does it appear from the opinion of the circuit court of appeals in that case that that court regarded the dividends as having been distributed

The court below held (R. 37–38) that Section 115 (h) has no bearing on Section 26 (c) (3) on the ground that Section 26 (c) (3) relates to the taxation of the corporation itself while Section 115 (h) has reference not to the taxes or credits of the corporation but only to the taxation of the shareholder.[10] We submit that the court in this respect has failed to give to Section 115 (h) its proper operative effect. As the language of

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in such years. The record in that case showed that the stock dividends had been declared in earlier years, and it was only by such earlier distributions that the taxpayer could have hoped to come under Section 26 (c) (3), for that Section speaks of a deficit "as of the close of the preceding taxable year". And if the nontaxable stock dividends were issued during the taxable years involved in that case, Section 27 (h) of the Revenue Act of 1936 (Appendix, *infra*, pp. 42–43) would have prevented a dividends paid credit. Finally, it is difficult to see in any case how a stock dividend declared "out of earnings and profits" can directly create a deficit in the earnings and profits. The holding in that case was that "earnings and profits" are not diminished by a nontaxable stock dividend and accordingly that in the federal tax sense no deficit arose, since, disregarding the stock dividend, the accumulated earnings and profits exceeded subsequent operating losses of the taxpayer.

[10] The Circuit Court of Appeals for the Sixth Circuit in *United States* v. *Byron Sash & Door Co.*, 150 F. 2d 44, and the District Court for the Eastern District of Pennsylvania, in *Philadelphia Carpet Co.* v. *United States*, decided August 30, 1946 (1946 C. C. H., par. 9350), are in accord with the court below. Compare, however, the later decision of the Sixth Circuit in *Long* v. *Commissioner*, 155 F. 2d 847, in which that court held that the capitalization of earnings and profits by the issuance of nontaxable stock dividends did not result in changing the earnings into capital for federal tax purposes.

that Section and its legislative history clearly show, its purpose was to crystallize into a statutory provision the rule with regard to the effect upon "earnings and profits" of a corporation of certain nontaxable corporate exchanges and nontaxable dividends. When Congress, in 1942, added Section 26 (c) (3) to the Revenue Act of 1936, using therein the term "earnings and profits", it employed that term in the tax sense, and the term in the tax sense must be read in conjunction with Section 115 (h).

In the court below, the taxpayer advanced the contention that Section 115 (h) was not applicable because it provides that a nontaxable stock dividend shall not be considered a "distribution" of earnings and profits. The taxpayer's position is that it may readily concede that its 1924 stock dividend did not effect a "distribution" of earnings and profits, but, it contends, such stock dividend did effect a "capitalization" of $100,000 of its accumulated earnings and profits, and that its earnings and profits were therefore depleted to that extent. For its position in this regard, the taxpayer relied below, and in its brief in opposition to certiorari, upon certain state court decisions and upon the following federal court decisions: *Eisner* v. *Macomber*, 252 U. S. 189; *Commissioner* v. *Cordingley*, 78 F. 2d 118 (C. C. A. 1); *Patty* v. *Commissioner*, 98 F. 2d 717 (C. C. A. 2); *Commissioner* v. *Champion*, 78

F. 2d 513 (C. C. A. 6); *Commissioner* v. *Quackenbos*, 78 F. 2d 156 (C. C. A. 2), and *Commissioner* v. *Ahlborn*, 77 F. 2d 700 (C. C. A. 3). See Br. in Opp., pp. 17–22.

For present purposes, it is immaterial that under state law a stock dividend is treated as capitalizing earnings and profits. Cf. *Commissioner* v. *Wheeler*, 324 U. S. 542. The case of *Eisner* v. *Macomber, supra*, presented the question of the constitutional validity of an income tax upon a true stock dividend, and the basis of the decision was that such a dividend does not effect a distribution of the corporation's earnings. The other federal decisions involved Section 115 (g) of the Revenue Act of 1928, c. 852, 45 Stat. 791, or comparable provisions of other Revenue Acts relating to the cancellation or redemption by a corporation of its stock "at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend."

We submit that the decision of this Court in *Commissioner* v. *Estate of Bedford*, 325 U. S. 283, in effect overrules the circuit court of appeals decisions in the *Cordingley*, *Patty* and similar cases cited above. The Circuit Court of Appeals for the Second Circuit in *Kirschenbaum* v. *Commissioner*, 155 F. 2d 23, agreed that this was the effect of the *Bedford* decision, and there

seems little ground to doubt the accuracy of this conclusion. In the *Bedford* case, this Court, reversing the decision of the Second Circuit in that case which had relied upon the *Patty* and *Quackenbos* cases, *supra*, recognized that a distribution of cash by a corporation was out of earnings and profits and had the effect of the distribution of a taxable dividend under Section 112 (c) (2) of the Revenue Act of 1936, notwithstanding the fact that the books of the corporation showed a deficit in the surplus account because earlier nontaxable stock dividends had been charged against it. We believe it to be beyond question from the *Bedford* decision that the distribution of a nontaxable stock dividend does not convert earnings and profits into capital for federal tax purposes.[11]

[11] It may be noted that in the Excess Profits Tax Act of 1940, enacted by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, where "capital" of a corporation has become a relevant factor in determining a corporation's taxes, Congress has provided in Sections 713 (c) (3) and 718 (c) (1), that a distribution by a corporation to its shareholders in its stock or rights to acquire its stock "shall not be regarded as money or property paid in for stock, or as paid in surplus, or as a contribution to capital". In Section 718 (a) (3), distributions of stock are included in equity invested capital to the extent to which they are considered "distributions of earnings and profits" and in Section 718 (a) (4) "accumulated earnings and profits" are included in equity invested capital. In H. Rep. No. 2894, 76th Cong., 3d Sess., p. 24 (1940-2 Cum. Bull. 496) it was stated that taxable stock dividends are included in invested capital because they represent, in effect, a reinvestment of earnings in the business, but that, conversely,

To conclude that a nontaxable stock dividend may not create or contribute to a deficit in accumulated earnings and profits within the meaning of Section 26 (c) (3) of the Revenue Act of 1936, as added in 1942, is to harmonize that Section with the Congressional purpose evidenced in Section 27 (h) of the Revenue Act of 1936 (Appendix, *infra*, pp. 42–43), which prohibits a dividends paid credit if any part of a distribution, including stock dividends, is not a taxable dividend. If a credit may not be secured by virtue of the distribution of a nontaxable stock dividend in the year of distribution, there would seem to be little reason to suppose that Congress intended that such a distribution might form the basis for a credit in succeeding years. The legislative history of Section 501 of the Revenue Act of 1942, which added Section 26 (c) (3) to the Revenue Act of 1936, clearly indicates, as we have shown, that it was not the purpose of Congress to allow such a credit.

Finally, it may be observed that the present case involves in substance the same principle which formed the basis of this Court's decision

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"if a stock dividend was not subject to tax in the hands of the distributee because it did not constitute income to him within the meaning of the sixteenth amendment to the Constitution or was no taxable to him under the applicable revenue law, it is not deemed to reduce the earnings and profits account and is therefore already reflected in the accumulated earnings and profits".

in *Commissioner* v. *Wheeler*, 324 U. S. 542. In that case, the Court pointed out that Congress has determined that in certain types of transactions the economic changes are not definitive enough to be given tax consequences, and the Court stated (p. 546) that it is sensible to carry through the theory in determining the tax effect of such transactions on "earnings and profits". In that connection, this Court cited with approval the case of *Commissioner* v. *Sansome*, and S. Rep. No. 2156, cited *supra*, p. 15. It could hardly be contended, in view of the *Wheeler* decision, that problems of the basis to be used in computing "earnings and profits" and the time at which realized but unrecognized gains and losses are to be brought into "earnings and profits" are to be decided one way in determining income tax and another way in determinifig the undistributed profits tax credit. We believe it apparent that Congress intended a uniform rule to be applied. By the same reasoning, Congress plainly intended, we submit, that the uniform rule to the effect that nontaxable stock dividends do not diminish "earnings and profits" should also be applied in determining whether a corporation has a deficit in accumulated earnings and profits under Section 26 (c) (3).

C. The Treasury Regulation, which limits the credit under Section 26 (c) (3) to a "deficit in accumulated earnings and profits" in the federal

tax sense, is a valid exercise of the rule-making power.—The example illustrating the application of the provisions of Section 26 (c) (3) contained in S. Rep. No. 1631, referred to above, pp. 19–20, is also contained in Article 26–2 of Treasury Regulations 94 (Appendix, *infra*, pp. 45–47). As we have heretofore pointed out, this example, while in terms referring to a deficit in accumulated earnings and profits on the corporation's books by reason of a prior capitalization of surplus in the course of a nontaxable reorganization, establishes the principle that the credit which is allowable under Section 26 (c) (3) is the deficit in accumulated earnings and profits for federal income tax purposes irrespective of whether state law may attribute a different meaning to the term.

The administrative practice established in these regulations has been approved by the Tax Court in *Century Electric Co.* v. *Commissioner*, 3 T. C. 297, affirmed, 144 F. 2d 983 (C. C. A. 8). The Treasury Department's construction of the statute is not unreasonable or inconsistent with the statute and should be upheld. At the minimum it represents a permissible construction upon a doubtful point by the officials charged with administering the law, and there should be more weighty reasons than are here apparent for disturbing this administrative construction. Cf. *Commissioner* v. *Wheeler*, 324 U. S. 542; *Fawcus*

Machine Co. v. *United States*, 282 U. S. 375, 378; *Brewster* v. *Gage*, 280 U. S. 327, 336. See also *Great Lakes Coca-Cola Bot. Co.* v. *Commissioner*, 151 F. 2d 174 (C. C. A. 7), upholding a provision of the same regulation as is here involved.

II

THE COURT BELOW ERRED IN IMPORTING CONCEPTS OF STATE LAW INTO THE TERM "DEFICIT IN ACCUMULATED EARNINGS AND PROFITS"

Despite the special meaning which has been given the term "earnings and profits" in federal tax law generally, and in Section 26 (c) (3), and despite the Treasury Regulation to the contrary, the court below granted a credit to the taxpayer corporation because a corporation which exists under Louisiana law and "has a deficit and not a surplus under that law and is thereby prevented from paying dividends, is a corporation protected by" Section 26 (c) (3) (R. 36). This conclusion is justified neither by the words of the statute nor by the Congressional purpose in enacting Section 26 (c) (3).

Nothing in the two uses of the phrase "deficit in accumulated earnings and profits" in Section 26 (c) (3) requires that that term be read in the light of state law, as the court below thought it should, to avoid attributing a different meaning to the term used the first time from that given to it in its second use (cf. R. 36). Properly read,

Section 26 (c) (3) means, as has been shown (*supra*, pp. 17–30), that the credit is available to a corporation having a "deficit in accumulated earnings and profits" in the federal tax sense if that corporation is prevented by law or order of a public regulatory body, in effect before May 1, 1936, from paying dividends when it has a "deficit in accumulated earnings and profits" within the meaning of federal tax law.

That Congress could not have intended to grant a credit to every corporation forbidden to pay dividends, as the court below apparently assumed, is manifest not only from the language it used in Section 26 (c) (3), but also from the related provisions in Section 26 (c) (1) and (2). See *infra*, pp. 40–41. Under these provisions, oral contracts forbidding dividends,[12] or restrictions imposed within the body corporate,[13] for example, will not afford a basis for the credit. The credit under Section 26 (c) (3), similarly, is limited and is granted only to corporations having a deficit in accumulated earnings and profits. It follows that a ban on distributions, whether by state law or otherwise, is not itself determinative; what is required is a literal compliance with the terms of the federal statute.

It cannot be supposed that Congress intended, by implication, to import state law concepts into

[12] *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 52.

[13] *Hercules Gasoline Co.* v. *Commissioner*, 326 U. S. 425.

Section 26 (c) (3) when it did no such thing in the other subdivisions of Section 26. Cf. *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 49; *Helvering* v. *Northwest Bancorporation*, 140 F. 2d 958 (C. C. A. 8), certiorari denied, 322 U. S. 726. Section 14 of the Revenue Act of 1936 (Appendix, *infra*, p. 39), which imposes the surtax on undistributed profits, itself indicates that there is a correlation between the various provisions of that Section and also between Section 26 and Section 27. Appendix, *infra*, pp. 40–43. This conclusion is strengthened by Section 26 (c) (4) of the Revenue Act of 1936, as amended by Section 501 of the Revenue Act of 1942 which is headed "Double Credit Not Allowed", and provides that if more than one of the credits provided in subdivisions (c) (1) and (c) (2) and the new subdivision (c) (3) of Section 26 apply, then the paragraph which allows the greatest credit shall be applied, and, if the credit allowable under each paragraph is the same, only one of such paragraphs shall be applied. Congress has thus indicated that it considered the three subdivisions as interdependent since it has made the relief obtainable under one paragraph exclusive. Cf. *Hercules Gasoline Co.* v. *Commissioner*, 326 U. S. 425. It is untenable, therefore, to conclude that Congress used the term "earnings and profits" in a different sense in the interdependent subsections. If there could be

any doubt of this, it would seem to be resolved by that portion of Section 501 of the Revenue Act of 1942 adding a new subsection (f) to Section 26 of the Revenue Act of 1936 (Appendix, *infra,* pp. 41–42) headed "Deficit Credit" in which the term "earnings and profits" appears several times, and as to which there can be no question that such "Deficit Credit" was not made to depend upon what might be considered a deficit in earnings and profits under state law.

Moreover, the terms "earnings and profits" and "deficit in accumulated earnings and profits" have never acquired a fixed meaning either in corporate finance and accounting or for purposes of state or other regulatory laws. These terms are unlike the word "surplus", which is commonly employed to designate an account on the corporate books representing the net assets of a corporation in excess of all liabilities including its capital stock. Cf. *Edwards* v. *Douglas,* 269 U. S. 204, 214. Indeed, the statute of Louisiana here involved (Appendix, *infra,* pp. 43–45) prohibits the payment of dividends "except from the surplus of the aggregate of its assets over the aggregate of its liabilities, plus the amount of its capital stock". The term "deficit in accumulated earnings and profits" is not used in the Louisiana statutes, nor does it appear that such term would have any fixed meaning under the law of that State. Other State limitations on dividend distri-

butions use phrases such as net earnings, surplus arising from the business earnings, actual net earnings, actual legitimate net earnings, profits earned by the business, net profits, profit, accumulated profits, net profits actually acquired, profits actually earned and on hand, and net profits properly applicable thereto. Not only does there seem to be no settled usage with respect to these terms in commerce, but it has been said that the economists themselves are at hopeless loggerheads. Weiner, *Theory of Anglo-American Dividend Law* (1929), 29 Col. L. Rev. 461.

It is true that under Section 26 (c) (3) it is necessary to look to local law or to orders of public regulatory bodies to determine whether there is a prohibition against the payment of dividends by the taxpayer corporation during the existence of a deficit in accumulated earnings and profits, but resort to local law or to orders of public regulatory bodies for this limited purpose is permitted only because Congress has *expressly conditioned* the right to the prescribed credit upon a showing of the existence of such a prohibition under a provision of a law or of an order of a public regulatory body. This does not mean, however, that the question of the amount of the credit to which the taxpayer will become entitled, namely, the amount of the deficit, or the question whether the taxpayer in fact has a deficit in accumulated earnings and profits within the mean-

ing of Section 26 (c) (3) is to be determined by state law, as held by the court below. Under the wording of Section 26 (c) (3), there would be no greater justification for resorting to state law in the determination of the existence and amount of a deficit than there would be in resorting to orders of public regulatory bodies in the determination of such questions, and there has been no suggestion by the taxpayer or by the court below that orders of such bodies may be resorted to for that purpose.

The federal revenue laws are designed to establish a nation-wide scheme of taxation uniform in its application and they should be construed in the light of this general purpose. There is no language or necessary implication in that portion of Section 26 (c) (3) which constitutes the grant of the allowance, namely, "In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit", which makes its operation dependent upon state law. It is clear, we submit, that Congress did not intend to relegate the many troublesome questions concerning the existence and amount of accumulated earnings and profits for purposes of Section 26 (c) (3), here involved, to the uncertain field of local law, when Congress itself had, prior to the enactment of the Revenue Act of 1942, recognized the existence of the uncertainties of state law, and

had adopted legislation to resolve some of the more difficult questions. Cf. *Commissioner* v. *Wheeler*, 324 U. S. 542; *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46; *United States* v. *Pelzer*, 312 U. S. 399, 403; *Lyeth* v. *Hoey*, 305 U. S. 188, 193; *Burnet* v. *Harmel*, 287 U. S. 103, 110.

CONCLUSION

The decision below is erroneous and should be reversed.

Respectfully submitted,

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JANUARY 1947.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

(A) The normal tax imposed by section 13.

(B) The credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(C) In the case of a holding company affiliate * * *

(D) In the case of a national mortgage association * * *

(2) [as amended by Section 501 of the Revenue Act of 1942, c. 619, 56 Stat. 798] The term "undistributed net income" means the adjusted net income minus the sum of (A) the dividend paid credit provided in section 27, (B) the credit provided in section 26 (c) relating to restrictions on payments of dividends, (C) except in cases where section 26 (c) (1) is applicable, the deficit credit provided in section 26 (f), and (D) the redemption credit provided in section 26 (g).

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

* * * * * *

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

(a) *Interest on Obligations of the United States and Its Instrumentalities.*—* * *

(b) *Dividends Received.*—* * *

(c) [as amended by Section 501 of the Revenue Act of 1942] *Restrictions on Payment of Dividends.*—

(1) *Prohibition on payment of dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.

(2) *Disposition of profits of taxable year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such

amount has been so paid or set aside. For the purpose of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

(3) *Deficit corporations.*—In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936.

(4) *Double credit not allowed.*—If more than one of the credits provided in the foregoing paragraphs (1), (2), and (3) apply, then the paragraph which allows the greatest credit shall be applied; and, if the credit allowable under each paragraph is the same, only one of such paragraphs shall be applied.

(d) *Bank Affiliates.*—* * *

(e) *National Mortgage Associations.*—* * *

* * *

(f) [as added by Section 501 of the Revenue Act of 1942] *Deficit Credit.*—The amount by which the adjusted net income exceeds the sum of (1) the earnings and profits accumulated after February 28, 1913, as of the beginning of the taxable year, and (2) the earnings and profits of the taxable year (computed as of the

close of the taxable year without diminution by reason of any distributions made during the taxable year. For the purposes of this subsection, earnings and profits of the taxable year shall be computed without diminution by the amount of the tax imposed under section 14, 102, 103, or 351 for such taxable year; and earnings and profits accumulated after February 28, 1913, as of the beginning of the taxable year, shall be diminished on account of the tax under section 14, 102, 103, or 351 for any previous taxable year only by the amount of such tax as computed under the amendments made by section 501 of the Revenue Act of 1942.

(g) [as amended by Section 501 of the Revenue Act of 1942] *Stock Redemption Credit.*—An amount equal to the portion of the recognized gain, realized within the taxable year and prior to March 3, 1936, from the sale or other disposition of a capital asset, which, pursuant to a contract, was distributed prior to such date to shareholders in redemption in whole or in part of preferred stock and which is not otherwise allowable as a credit under any other provision of this section or section 27.

SEC. 27. CORPORATION CREDIT FOR DIVIDENDS PAID.

(a) *Dividends Paid Credit in General.*—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year.

* * * * *

(h) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under

this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * *

(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

* * * * *

Louisiana Acts (1928), Act No. 250:

SECTION 26. DIVIDENDS: METHOD OF ESTIMATING FUND FOR PAYMENT OF.

I. No corporation shall pay dividends in cash or property,

(a) except from the surplus of the aggregate of its assets over the aggregate or its liabilities, plus the amount of its capital stock; or

(b) out of any surplus due or arising from—

(1) any profit on treasury shares before resale; or

(2) any unrealized appreciation in value or revaluation of fixed assets; or

(3) any unrealized appreciation in value or revaluation of inventories before sale; or

(4) the unaccrued portion of unrealized profit on notes, bonds or obligations for the payment of money, purchased or otherwise acquired, unless such notes, bonds or obligations are readily marketable, in which case they may be taken at their actual market value; or

(5) the unaccrued or unearned portion of any unrealized profit in any form whatever, whether in the form of notes, bonds, obligations for the payment of money, installment sales, credits or otherwise, except as provided in the preceding subparagraph (4).

II. In case all or any part of any cash dividend is paid out of paid-in surplus, the shareholders shall at the time of payment be notified of that fact.

III. No corporation shall pay dividends in shares of the corporation, except from the surplus of the aggregate of its assets, which, for this purpose only, may include items mentioned in Subdivision I (b), over the aggregate of its liabilities, plus the amount of its capital stock.

IV. In computing the aggregate of the assets of the corporation, for the purpose of dividends, whether payable in cash, property or shares, proper allowance shall be made for depreciation and depletion sustained, and ascertained or known losses of every character. Deferred assets and prepaid expenses shall be considered as assets only to the amounts not used or not accrued.

V. Subject to the limitations contained in this Section, a dividend may be declared in shares of the corporation, whenever the

board of directors so determine, provided that,

(a) if the dividend is to be paid in shares having a par value, the aggregate par value of such shares shall not exceed the amount of that portion of the corporation's surplus which is transferred to capital as payment for such shares;

(b) if the dividend is paid in shares having no par value, the number of such shares shall be fixed by the board of directors;

(c) no dividend payable in shares of any class shall be paid to shareholders of any other class, unless the articles so provide, or such payment is authorized by the vote of the holders of a majority of the shares of the class in which the payment is to be made.

* * * * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

Art. 26–2. [As amended by T. D. 5263, 1943 Cum. Bull. 1003.] *Credit in Connection With Restrictions on Payment of Dividends.*—

* * * * * *

(d) *Deficit corporations.*—Under the provisions of section 26 (c) (3), a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year is allowed as a credit the amount of such deficit to the extent that the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936. Whether such a deficit exists as of the

close of the preceding taxable year is a question to be determined from the facts and circumstances of each particular case. In any such case the taxpayer must show how the deficit arose, whether from operating losses, capital distributions in excess of earnings and profits, or other causes. In addition the taxpayer must show, under a law or an order of a public regulatory body, the extent to which it could not legally have paid dividends during the existence of such deficit. A State law, for example, might permit the payment of a dividend from unrealized appreciation in value of assets even though the corporation had a deficit in accumulated earnings and profits. A deficit in accumulated earnings and profits can arise only out of the operation of the business at a loss and can not be caused by distributions to shareholders in excess of the amount of accumulated earnings and profits. If distributions are made to shareholders out of accumulated earnings and profits, however, such distributions may contribute to the creation of a deficit by so exhausting the accumulated earnings and profits that they are incapable of absorbing a loss thereafter resulting from the business. Unrealized appreciation or depreciation in value of assets is not a factor in determining accumulated earnings and profits.

The application of the provisions of section 26 (c) (3) may be illustrated by the following examples:

Example (1).—The M Corporation for the calendar year 1936 had an adjusted net income of $200,000 but had an actual deficit in accumulated earnings and profits as of December 31, 1935, of $20,000. By

reason of a State law in effect prior to May 1, 1936, with respect to deficit corporations, the M Corporation was prohibited from paying dividends during the existence of such deficit. Under section 26 (c) (3), the M Corporation is allowed a credit of $20,000.

Example (2). Assume in the above example that the deficit in the accumulated earnings and profits is $20,000 for income tax purposes, but the deficit on the corporation's books by reason of a prior capitalization of surplus in the course of a nontaxable reorganization amounts to $250,000. In this case, even though the State law might prevent the distribution of any dividends, the credit under section 26 (c) (3) is limited to $20,000, which is the deficit in accumulated earnings and profits for income tax purposes.

* * * * * *

S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 244–246 (1942–2 Cum. Bull. 504, 683–684):

SECTION 501. ADDITIONAL CREDITS FOR UNDISTRIBUTED PROFITS TAX.

This section is the same as in the House bill, except that a new paragraph to section 26 (c) has been added, providing for an additional credit in cases of corporations having a deficit in accumulated earnings and profits and prohibited by law from paying dividends, and except that a new subsection has been added providing for a stock redemption credit.

* * * * * *

Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax at various rates from 7 to 27 percent of their undistributed net income.

In some instances State law or an order of a public regulatory body prohibited payment of dividends during the existence of a deficit even though the corporation had current earnings and profits which would constitute undistributed net income under the definition thereof in section 14 (a) (2). Such corporations were, therefore, subject to undistributed profits surtax even though they were prohibited by law from paying dividends. The addition of the new paragraph 3 to subsection (c) of section 26 to provide an additional credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year is intended to give relief in certain of these cases.

* * * * * * *

The application of the deficit credits provided by these amendments may be illustrated by the following examples:

(1) The X corporation for the calendar year 1936 had an adjusted net income of $200,000 but had a deficit in accumulated earnings and profits as of the close of the preceding calendar year of $20,000. By reason of a State law in effect prior to May 1, 1936, with respect to deficit corporations, only $180,000 of this adjusted net income could be distributed as dividends. Under section 14 of the Revenue Act of 1936, X corporation would be subject to undistributed-profits surtax on $20,000 even though it paid out the entire amount which it could have distributed without violating the State law—namely, $180,000, as taxable dividends. Under the amendment to section 26 (c), X corporation would be allowed a credit of $20,000, and would not be liable

for any undistributed-profits tax for the calendar year 1936.

(2) Assume in the above example that the deficit in accumulated earnings and profits is $20,000 for income tax purposes, but the deficit in accumulated earnings and profits on the corporation's books by reason of a prior capitalization of surplus in the course of a nontaxable reorganization amounts to $250,000. In this case, although the State law would probably prohibit payment of any dividends, the credit allowed under the amendment to section 26 (c) is limited to $20,000, which is the deficit in accumulated earnings and profits for income tax purposes. X corporation, therefore, will be liable for undistributed profits surtax on $180,000 of its adjusted net income.

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No. 430

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1946

UNITED STATES OF AMERICA
Petitioner,

vs.

OGILVIE HARDWARE COMPANY, INC.
Respondent

BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

H. C. WALKER, JR.,
ELIAS GOLDSTEIN,
Attorneys for Respondent.

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Attorneys for Respondent.

SYLLABUS

1. By the 1942 amendment to Section 26 (c) of the 1936 Revenue Act, Congress placed on the same footing with regard to liability for surtax on undistributed profits deficit corporations which were forbidden by a state law from declaring dividends and those which were prohibited from so doing by a written contract antedating May 1, 1936.

2. A stock dividend lawfully declared prior to May 1, 1936 in the regular course of business and without intention to avoid or reduce income tax liability converts surplus assets into capital which is no longer available for distribution to stockholders.

3. Where such addition to capital occurred prior to May 1, 1936, it became a part of the capital of the corporation for all purposes; and except in those instances where Congress has specifically otherwise directed, it will be considered a part of the corporate capital in relation to income and other Federal taxes.

4. Under Louisiana law a deficit corporation such as respondent was at the close of its fiscal years ending May 31, 1937 and May 31, 1938 is strictly prohibited from declaring a dividend.

5. Under the practice and rules of this Court, a case involving merely the construction of a provision of the Federal Revenue laws which Congress has long ago repealed is not of sufficient importance to justify a review by this Court of the decision of a Circuit Court of Appeals interpreting such provision.

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MAY IT PLEASE THE COURT:

We can add nothing to the clear statements of the facts which will be found in both the opinion of the Court of Appeals (R. 35) and the petition for certiorari (pp. 2 to 4, incl.). We therefore pass at once to the legal issues.

We respectfully submit that certiorari should be denied here because

(a) The decision and opinion of the Court of Appeals are completely right;

(b) The question presented is one of liability for an undistributed profits tax under a section of the Federal tax laws which Congress has repealed and which is, therefore, not of sufficient importance to require interpretation by this Court;

(c) There is no conflict of decision among the three courts of appeals which have heretofore passed upon the matter when the decisions are considered in the light of what the court of appeals found to be the facts in each case.

We pause for an instant to supplement the statement of the question presented (Petition, p. 2) by adding this: The stock dividend was declared for an honest business purpose many years before Congress penalized nondistribution by corporations of current earnings.

We first discuss the "Reasons for Granting the Writ" as set forth in the petition.

We respectfully differ with the distinguished counsel for Petitioner in regard to the conflict between the decision in this case and that of the Eighth Circuit Court of Appeals in *Century Electric Company v. Commissioner, 144 Fed. (2d) 983.* We take the facts in the Century case as they are stated in the opinion of the Court of Appeals: for it was on the basis of those facts that the case was decided; and since we are interested

in the Century Electric Company case only from the standpoint of what it decided as a matter of law, the accuracy of its findings of fact is of no moment here. In order for there to be a conflict between the decision in the Century Electric Company case and the decisions in this case and in the case of *United States v. Byron Sash & Door Company, 150 Fed. (2d) 44*, there must be such a similarity of facts as found by the Courts of Appeals as would preclude a valid distinction between what was held to be the law in the three cases.

With the utmost deference for the opposing view, we submit that the vital distinction between the facts in this case and the facts as stated by the Court of Appeals for the Eighth Circuit in the Century Electric Company case was correctly pointed out by the Court of Appeals for the Sixth Circuit in the *Byron Sash & Door Company* case, supra.

> "According to the statute, the credit is allowed to a 'corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year.' What appears to us to have been a misconception on the part of the Collector is emphasized by a reference to the principal case on which the Government relies, Century Electric Co. v. Commissioner, 144 Fed. (2d) 983. (C.C.A.8) (44-2USTC §9463). There the corporation had large accumulated earnings and profits at the close of the taxable years 1935 and 1936, respectively. There was no claim that it had any deficit in earnings and profits for these years. In the year 1936, and again in 1937, it distributed non-taxable stock dividends. Before the Tax Court, as well as before the Circuit Court of Appeals, the corporation contended that by reason of the distribution of such stock dividends, it had become a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, within the meaning of Section 26 (c) (3) of the Revenue Act of 1936, as amended by the Revenue Act of 1942, Section 501

(a) (2), 26 U.S.C.A. Int. Rev. Acts; and that it was entitled to the credit of that section because it was prohibited from paying dividends by state law. The Court denied the credit on the ground that the non-taxable dividends distributed in 1936 and 1937, did not result in such a reduction in the earnings and profits for those years respectively, as to bring the company within the provisions of the statute as a deficit corporation. In other words, the Court held that where a corporation had a surplus, a deficit within the meaning of the statute under which a credit is allowed could not be effected by the distribution of a non-taxable stock dividend. In the Century Electric case, there was, therefore, no deficit but rather a surplus as of the close of each of the two taxable years preceding the distribution of the dividends, and accordingly no credit was allowed by the provisions of the statute. See also the report of the same case, Century Electric Co. v. Commissioner, in 3 T.C. 297 (CCH Dec. 13, 744). The obvious difference between the Century case and the one before us is that in the former, the claimed deficit was effected by the distribution of the stock dividends, while in the instant case it was effected by the preceding seven years of operating losses."

The difference between the facts in the *Century Electric Company* case and the facts in the instant case is sought to be minimized in the petition here (p. 7); but that it does exist exactly as stated by the Sixth Circuit decision in the *Byron Sash & Door Company* case appears when the opinion in the *Century Electric Company* case is read; for this is what the Circuit Court said were the facts upon which its decision was made:

"It appears that the taxpayer was at no time insolvent and its books showed large accumulated earnings and profits at the close of the taxable years 1935 and 1936, respectively, but instead of distributing the earnings and profits to its stockholders it had distributed non-taxable stock dividends,

common stock for common stock. It contended before the Tax Court, and contends here, that by reason of such stock dividends (and certain other claimed adjustments of its balance sheets) it had become a deficit corporation ('a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year') within the meaning of Section 26(c) (3), and that it was entitled to the credit of that section because it was prohibited from paying dividends by the law of Missouri where it is domiciled. The Tax Court held, in accord with Treasury Regulation 94, Rev. Acts 1936, 1942, Art. 26-2 (as amended by T. D. 5263, 1943 Cum. Bull. 1003, 1005, 1006 (d), that the non-taxable stock dividends distributed by the taxpayer did not serve to reduce the earnings and profits of the taxpayer, and that it had not become a deficit corporation within the meaning of the Act."

(*144 Fed. (2d) 983.*)

Expressions will be found in the *Century Electric Company* decision which are inconsistent with what the Court of Appeals for the Fifth Circuit said in its opinion here; but it is a familiar rule of law that what is said in an opinion is to be taken in connection with and as applied to the facts in that particular case and is not to be construed as stating a general rule applicable to different situations and different facts.

The second reason given for filing of the petition to review the construction by the court below of an unambiguous section of a tax law which has been repealed by Congress is that the court below held the law as passed by Congress to be of greater force than the Treasury Regulation interpreting it and also held that since the wording of the law is sufficiently plain to convey to the ordinary mind the sense of the words used, thus requiring no extrinsic aids to construction, it is not necessary to resort to a report of the Senate Committee on Finance for further light upon the meaning of the statute.

What the Court of Appeals held was what this Court under similar circumstances has repeatedly said. In *Lake County v. Rollins, 130 U. S. 662, 32 L. Ed. 1060,* this Court broadly laid down the general rule of construction of statutes and constitutions.

"We are unable to adopt the constructive interpolations ingeniously offered by counsel for defenddant in error. Why not assume that the framers of the Constitution and the people who voted it into existance, meant exactly what it says? At the first glance, its reading produces no impression of doubt as to the meaning. It seems all sufficiently plain; and in such case there is a well settled rule which we must observe. The object of construction, applied to a Constitution, is to give effect to the intent of its framers, and of the people in adopting it. This intent is to be found in the instrument itself; and when the text of a constitutional provision is not ambiguous the courts, in giving construction thereto, are not at liberty to search for its meaning beyond the instrument.

"To get at the thought or meaning expressed in a statute, a contract or a Constitution, the first resort in all cases, is to the natural signification of the words, in the order of grammatical arrangement in which the framers of the instrument have placed them. If the words convey a definite meaning, which involves no absurdity nor any contradiction of other parts of the instrument, then that meaning, apparent on the face of the instrument, must be accepted, and neither the courts nor the Legislature have the right to add to it or take from it. Newell v. People, 7 N. Y. 97; Hills v. Chicago, 60 Ill. 86; Denn v. Reid, 35 U. S. 10 Pet. 524 (9:519): Leonard v. Wiseman, 31 Md. 204; People v. Potter, 47 N. Y. 375; Cooley, Const. Lim. p. 57; Story, Const. § 400; Beardstown v. Virginia, 76 Ill. 34. So, also, where a law is expressed in plain and unambiguous terms whether those terms are general or limited,

the Legislature should be intended to mean what they have plainly expressed, and consequently no room is left for construction. United States v. Fisher, 6 U. S. 2 Cranch, 358, 399 (2:304,317); Doggett v. Florida R. Co. 99 U. S. 72 (25:301)."

(*32 L. Ed. 1063.*)

See also,
Caminetti v. United States,
242 U. S. 470, 61 L. Ed. 442.

The decision of this Court in *Bate Refrigerating Company v. Sulzberger, 157 U. S. 1, 39 L. Ed. 601,* is directly in point here.

" 'Where the language of the Act is explicit,' this court has said, 'there is great danger in departing from the words used, to give an effect to the law which may be supposed to have been designed by the legislature . . . It is not for the court to say, where the language of the statute is clear, that it shall be so construed as to embrace cases, because no good reason can be assigned why they were excluded from its provisions.' Denn v. Reid, 35 U. S. 10 Pet. 524, 527.

* * * *

"We cannot accept as controlling, much less conclusive, the opinion of the House Committee on the Revision of the Laws of the United States, as reported by Mr. Jenckes, that the bill it reported embodied only the existing law. Nor can we assume that the House of Representatives, much less the Senate, based their action upon the opinion of individual members of the House as to the scope and legal effect of the report of the revisers. Comparing the bill reported by the revisers and the bill reported by the House Committee on Patents, with the Act as it passed, we find it impossible to sustain the view taken by the plaintiff."

(*39 L. Ed. 611, 613.*)

The same argument that is advanced by the Petitioner here was rejected by this Court in *Pennsylvania Railroad Co. v. International Coal Mining Company, 230 U. S. 184, 57 L. Ed. 1446.*

> "But while they may be looked at to explain doubtful expressions, not even formal reports—much less the language of a member of a committee—can be resorted to for the purpose of construing a statute contrary to its plain terms, or to make identical that which is radically different."
>
> *(57 L. Ed. 1452.)*

To the same effect, see

Standard Fashion Company v. Magrane-Houston Company, 258 U. S. 346, 66 L. Ed. 653.

> "Much is said in the briefs concerning the reports of committees concerned with the enactment of this legislation, but the words of the act are plain, and their meaning is apparent without the necessity of resorting to the extraneous statements and often unsatisfactory aid of such reports. See Railroad Commission v. Chicago, B. & Q. R. Co., decided February 27, 1922, 257 U. S. 563, ante, 371, 42 Sup. Ct. Rep. 232, and previous decisions of this court therein cited."
>
> *(66 L. Ed. 657.)*

We have seen no better statement on the point than was made by the Court of Appeals in this case *(R 37)*:

> "That divergent meanings be given the same words in the beginning and end of the same clause is said to be required because the Committee which recommended the amendment to the Senate, after stating the object of the amendment as we have just stated it, illustrated its operation by two examples, in the latter of which it was indicated that when 'the deficit on the corporation's books was by reason

of a prior capitalization of surplus in the course of a non-taxable reorganization the deficit, so far as thus caused, would not be recognized though it might be by the State law. This example was copied into the Regulations also. It actually speaks only of reorganizations and not of stock dividends. We do not think the example is any part of the unambiguous Act of Congress. It is merely the opinion of the writer of the report on how the legislation would work out in the case of a non-taxable reorganization. The Constitution, Article 1, Section 7, states how the laws of the United States are made: by written Bill, passed by the House and Senate separately, transmitted to the President and approved by him, or passed over his veto. The provision is express that thus the same (the Bill) shall be a Law.' The report of a Committee of the Senate is not voted on—perhaps not read by—the members even of the Senate; but the words of the Bill are. The Bill is transmitted to the House, and it—not the Committee's report— is passed there. The Bill is then sent to the President for his approval. He does not approve a Committee report, if by any chance he should see it. He approves the words of the Bill and it becomes the law. Under the statutes on the subject the Bill as soon as passed by either House is printed and becomes the authentic Bill: 1 U. S. C. A. § 26. On final passage and printing, 44 U. S. C. A. § 196, the printed Acts are evidence of the laws passed; 1 U. S. C. A. § 30. The words of the Act are the law. Only when the words of the law are difficult of understanding can what happened in passing it be resorted to for aid. Its clear meaning cannot be so altered. Nor can anything be thus added to it. Nor can putting an example into the Regulation add to or change the law as passed."

"So recourse is had to Section 115 (h) of the Revenue Act of 1936, in substance stating that a distribution by or on behalf of a corporation shall not

be considered a distribution of earnings and profits of the corporation if no gain to such distributee was recognized by law or if the distribution was not subject to tax because it did not constitute income to him within the meaning of the Sixteenth Amendment. This Section has reference not to the taxes or credits of the corporation, but only to the taxation of the shareholder, as a reading of the whole Section will show. Subsection (h) means that when the shareholder gets something in the way of a dividend which is not presently taxable, it will be held taxable as a dividend when the impediment is removed, or the value which he has received is finally realized. Thus in Eisner vs. McComber, 252 U. S. 189, a stock dividend, which is a capitalization of earnings and profits of the corporation, was held not presently taxable to the shareholder because he had not realized any gain; but when on the liquidation of the corporation, or by sale of his stock he does realize the gain, it is all then taxable to him as gain. We do not think this provision has any bearing on the 1942 amendment under discussion, which relates to the taxation of the corporation itself for not distributing its current income."

(*R. 37, 38.*)

While we can see the importance in the case of a complicated and ambiguous statute of an examination of the legislative records behind the passage of the act, we submit that the Courts of Appeals correctly held that there was neither occasion nor excuse for resort to such extrinsic evidence when the language of the statute itself (the words being given their ordinary meaning) clearly indicates what Congress intended and what the President, whose approval was an essential part of the enactment of the statute into binding law, assented to. There is no implicit difference between the rules of construction of contracts between individuals and those properly applicable to the construction of a law. In either case the authority charged with the duty of con-

struing the contract or the law, as the case may be, looks first to the ordinary meaning of the language used. If that meaning is plain, the construer is required to go no further; but if the expressions used are ambiguous, then and then only is an inquiry justified into the background of the contract or the law and the surroundings in which it was confected or adopted.

We respectfully submit that when Congress passes a law and the President approves that law so that it becomes binding within constitutional limits upon the United States and upon all persons, and when the terms of that law are sufficiently explicit for its meaning to be understood by a competent court, Congress is conclusively presumed to have intended to enact the law in the words in which it is expressed and the President who approved the law is conclusively presumed to have approved it as written and the courts of the country and the Bar as a whole and the man in the street to whom the law applies are entitled to rely upon the plain and ordinary meaning of the words in which the act is couched and should not be obliged to test that meaning by what was said about the law before it was passed either in the Senate or in the House or in a committee report or in any other place.

We have here a law which is sufficiently plain for anyone to read and understand; and we submit that the law should be applied as it is written without regard to the interpretations of the law by a member of Congress, a Congressional Committee, a cabinet officer, a Treasury official, the Attorney General, or anyone else.

The third reason given for asking this Court to disturb the proper application of a repealed statute to a case arising prior to the repeal is that,

> "The question presented is nevertheless very much alive in cases pending in the District Courts within the Third, Fifth, Sixth, Seventh and Tenth Circuits, involving substantial amounts of revenue. It is in the interest of consistent administration of

the tax laws that the issue be authoritatively set at rest by this Court."

It seems almost incredible that an appeal should be made for consideration of this case by the Supreme Court of the United States on such a ground. Almost implicit in the language used is the assumption that this Court has become little more than a part of the administrative section of the Treasury Department. There is no evidence in this record to show that other cases involving the same question are pending in district courts; it appears to us in general to violate the proper conception of judicial process to seek a decision of a matter by this Court not on the basis of the record in the case but on the strength of statements made by counsel as to facts outside the record. Assuming the verity of these facts and assuming that "substantial" amounts of revenue are involved, what has that to do with the granting of a writ of certiorari by this Court? And what is meant by "substantial" amounts of revenue?

We assume that the Petitioner has stated its case as strongly as possible and that there is a case pending in the Third Circuit and one in the Fifth Circuit, one in the Sixth Circuit, one in the Seventh and one in the Tenth Circuit involving this same question. Let us suppose that they are all decided in a way that this Court would not decide them. We still say that because of the repeal of the statute and because no matter what is the decision of this Court, it will guide no one in respect to future tax liability, attempted resort to the supervisory power of this Court in a case like this is an imposition on the time of the Court and a waste of that time; it implies a lack of respect for the dignity of the Court and for the importance of its functions and powers.

On the merits of the case it is difficult to improve upon the opinion of the Court of Appeals; but we supplement it by these observations:

In amending paragraph 3 of Section 26 (c) of the Revenue Act of 1936 so as to afford relief to corporations situated similarly to the respondent here, Congress in 1942 enacted and the President approved a provision retroactively relieving certain deficit corporations from the penalties of the 1936 statute; and these are the words of the statute itself:

> "(3) Deficit corporations. In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936."

It will be noted that the amendment to the statute uses the expression "deficit in accumulated earnings and profits" twice. We think there can be no reasonable ground for denying that the second use of the expression refers to a deficit in accumulated earnings and profits as determined by the law of the state: for the existence of a deficit in itself does not authorize the exemption—there must be both the deficit and a provision of a law or an order of a public regulatory body prohibiting payment of dividends while such deficit exists. It is manifest that Congress was referring here to a provision of state law and it is equally manifest that it was referring to a deficit in accumulated earnings and profits as defined by that state law to constitute a bar to the payment of dividends.

It was stipulated (*R. 15*) that the taxpayer's books on May 31, 1936 disclosed a deficit of $74,875.10 and on May 31, 1937 a deficit of $71,347.18. The Louisiana statute (Act No. 250 of 1928) which is reproduced on pages 13 and 14 of the petition for certiorari in unmistakable terms prohibits payment of dividends by any corporation where the effect of such payment would be the diminution of the capital; and certainly a

corporation which has a large deficit instead of a surplus at the end of its fiscal year cannot pay a dividend except out of what is left of its capital.

The Petitioner attempts to avoid this conclusion by separating the capital of the Respondent into two parts, one being that which was originally subscribed and the other being the addition to the capital as a result of the stock dividend declared in 1924. As to the latter, the Petitioner assigns to it an amorphous character as both capital and surplus and contends that although for other purposes it was merged into and became a part of the new capital of the corporation, for the purpose of the question involved here it remained a part of the surplus. Petitioner argues accordingly that treating the half of the capital which was added in 1924 not as capital but as surplus has the effect of transforming the Respondent from a corporation with a deficit to a corporation with a surplus and thus deprives it of the protection which Congress in the 1924 Revenue Act extended to corporations prohibited by state law from declaring dividends.

The argument thus made it not consonant with universally accepted principles of the law of corporations. In *Fletcher Cyc. Corp., Perm. Ed., Vol. II, Title "Stock and Stockholders", Chap. 5362,* the general rule is thus succinctly stated:

"A stock dividend converts surplus assets into capital."

Among the authorities cited to support the text are,

Equitable Trust Company v. Prentice,
250 N. Y. 1, 164 N. E. 723;

Harding v. Staples,
111 Ken. 325, 149 Atl. 846;

Green v. Bissell,
79 Conn. 547, 65 Atl. 1056; 8 L. R. A. (NS) 1011;
118 Am. St. Rep. 156; 9 Ann. Cas. 287;

Bryan v. Aikin,
10 Del. Ch. 1. 82 Atl. 817;

In re Joy's Estate,
247 Mich. 418, 225 N. W. 878;

Lamb v. Lehmann,
110 Ohio St. 59, 143 N. E. 276;

In re Estate of Heaton,
89 Vt. 550, 96 Atl. 21;
L. R. A. 1916A 201;

to which list we add,

Eisner v. Macomber,
252 U. S. 189, 64 L. Ed. 521;

Commissioner v. Cordingley,
78 Fed. (2d) 118 (1st Cir.);

Patty v. Helvering,
98 Fed. (2d) 717 (2nd Cir.);

Commissioner v. Champion,
78 Fed. (2d) 513 (6th Cir.);

Commissioner v. Quackenbos,
78 Fed. (2d) 156 (2nd Cir.);

Commissioner v. Ahlborn, et al.,
77 Fed. (2d) 700 (3rd Cir.).

In *Green v. Bissell*, supra, the Supreme Court of Connecticut held that,

> "The declaration of a stock dividend involves the creation and issue of new shares of stock. The basis of the issue, in so far as payment into the corporation is required of the recipient, is surplus assets which thus become converted into strict capital with all which that implies.";

and in *Lamb v. Lehman*, supra, the Supreme Court of Ohio said,

> "A declaration of a so-called stock dividend has no other effect, so far as the corporation itself is

concerned, than to carry the position of the surplus covered by such stock dividend into the permanent capital account, thereby placing it beyond the power of the Board of Directors to withdraw it from corporate use and distribute to stockholders.";

and in *In re Estate of Heaton*, supra, the Supreme Court of Vermont declared that,

"Such dividend operates to transfer distributable assets to the individual ownership of the stockholders, thus changing accumulated surplus into permanent capital, and thereby creating an additional liability of the corporation."

In *Eisner v. Macomber*, supra, this Court pointed out that,

"A 'stock dividend' shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. *Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.*"
(*Emphasis ours.*)

In the application for certiorari it appears to be assumed that there is a so-called "Federal rule" which is different from the jurisprudence of the state courts over the country; but no such "Federal rule" is found in the decisions of the Federal courts and there is nothing in the Federal law itself nor the jurisprudence interpreting that law which differentiates the meaning of the term "deficit in accumulated earnings and profits" from the meaning generally and consistently given to such term by both state and Federal courts in a long series of decisions extending over a period of many years.

In *Commissioner v. Cordingley, 78 Fed. (2d) 118,* the Court of Appeals for the First Circuit said:

> "We think there was a consistent legislative purpose in the statutes beginning with the act of 1921 and extending into the act of 1928, viz., that corporations should be permitted to capitalize earnings by stock dividends issued for legitimate purposes, that stock so issued should stand on the same footing as other stock, and that the owner of it should be taxed on the profit or loss when it was converted into money. As has been said, this view has been long accepted by the Board of Tax Appeals and by various courts of appeal before which the question has come.";

and in *Commissioner v. Quackenbos, 78 Fed. (2d) 156,* the Court of Appeals for the Second Circuit slightly elaborated on this view, which met with its approval.

> "We can see no difference between capitalizing surplus earnings and investing them in plant or in using them, when so capitalized, as working capital that is advantageous for the conduct of the business. Here the earnings were not temporarily impounded, but subjected to the risk of the business of the Woonsocket Worsted Mills for eight years. The language of subsection (g) making the test whether the redemption and distribution are 'essentially equivalent to * * * a taxable dividend' depend on the 'time' and 'manner' of redemption clearly shows that not every redemption of stock and distribution of capitalized earnings which have accrued since Feb. 28, 1913 is 'essential equivalent to * * * a taxable dividend'. A long series of decisions of the Board of Tax Appeals has made the test of whether a distribution is 'essentially equivalent to * * * a taxable dividend' turn on whether the capitalization was for an honest business purpose and that again to depend on the particular facts of each case."

The overwhelming weight of authority is to the effect that when the Respondent transferred $100,000

from its surplus to its capital account in 1924 by declaring a stock dividend, its capital thereafter was $200,000 whereas it had been $100,000; and this $200,000 was its capital for all purposes—not merely for some. This stock dividend was declared by the Respondent many years before Congress levied a tax upon undistributed profits. It was a corporate act done in good faith for a strictly business purposes and had no relation to the avoidance or reduction of Federal income taxes. There is, it seems to us, no logical basis for the attempted distinction between the capital originally subscribed and the addition made to it in 1924.

This was the conclusion of the United States Circuit Court of Appeals for the Sixth Circuit in the case of *United States v. Byron Sash & Door Company, 150 Fed. (2d) 44*, in which the court after stating facts closely analogous to those in the present case, said:

> "The Commissioner's contention is based upon the ground that the taxpayer's deficit was the result of the $130,000 non-taxable stock dividend declared in 1929. It is argued that, since non-taxable stock dividends do not affect or diminish earnings and profits, they, therefore, cannot cause a deficit, and there was in this case, therefore, no deficit in the taxpayer's accumulated earnings or profits."

The court then refers to the argument of the Commissioner that because Section 115 (h) of the Internal Revenue Code provides that such a stock dividend shall not be considered a distribution of earnings or profits of the corporation, it cannot cause a deficit in earnings and profits and that,

> "Because the foregoing section provides that a stock dividend, like that in this case, shall not be considered a distribution of earnings or profits, it is urged that such a dividend cannot cause a deficit in earnings and profits, and that, consequently, a corporation whose deficit on its books results from

a distribution of tax-free stock dividends may not, within the meaning of the statute, have the benefit of the credit granted by Section 501 of the Revenue Act of 1942."

Then the court pointed out what the Commissioner had overlooked; and what it said is just as applicable to this case as to the case before it.

"Appellee does not claim that the distribution of the stock dividends was a distribution of the company's earnings and profits. On the contrary, it is maintained that there never was any such distribution, but rather that the earnings and profits were capitalized by the act of the corporation in transferring them to its capital account and were no longer available for distribution to stockholders. It is submitted by appellee that by the action of the corporation, the earnings and profits became, as of the time of the declaration of the dividend, merged and coalesced with the capital, and became subject to all the limitations imposed by law upon corporate capital.

"Section 115 (h) deals with the taxable status of the stockholder who receives stock dividends, rather than with the liability of the corporation for tax, and to use this provision of the statute in order to ignore the deficit in the case before us, and to deny credit on undistributed profits surtax to this corporation, seems untenable."

In the petition for certiorari reference is made to the decision of this Court in *Commissioner v. Estate of Bedford 325 U. S. 283, 89 L. Ed. 1611*, as presenting a situation similar to the one before the Court here. It does not seem to us that the similarity exists. On the contrary, the facts in the two cases are so different that the opinion of this Court in the Bedford case appears to us to be irrelevant here. In the cited case the taxpayer was a holder of shares of Abercrombie & Fitch Company, which was reorganized, the reorganization resulting in a distribution of both stock and cash.

"The sole issue is whether the tax, $45,240, is taxable as a dividend or merely as a capital gain to the extent of 40%."

There was no question in the Bedford case of any tax on undistributed profits or relief from such tax, and *it was conceded that although a book deficit in the surplus account had been created by earlier stock dividends, earnings and profits exceeding the distributed cash had been earned at the time of the recapitalization.*

"That cash therefor came out of earnings and profits and such a distribution would normally be considered a taxable dividend, see § 115 par. (a), 26 USCA § 115(a), 6 FCA, Title 26, § 115(a)."

All that the court held in the Bedford case was that cash distributed by a corporation to its shareholders is a taxable dividend if the cash came out of the earnings of the corporation since February 28, 1913; and having found in the Bedford case that the cash received by the taxpayer was a dividend, it held the taxpayer liable for income tax thereon.

What this holding has to do with the decision of the case at bar we cannot see. There is no question here of the impact of the income tax laws or any provisions thereof upon a shareholder, and there is no question of the payment of dividends. It is useless to attempt to draw from a decision construing one provision of the Federal income tax laws a conclusion as to liability under another and separate provision. In matters of taxation—and particularly income taxation—it is the statute and not reason and logic and equity which determines liability. Every income tax statute so far passed abounds in inequities, inconsistencies and inequalities. It is the language which Congress uses and which the President approves in enacting a particular provision of the revenue laws that determines liability under that provision; so that a case which deals only with the liability of a stockholder for the receipt of cash cannot reasonably be said to be authority

for the construction one way or the other of another part of the income tax laws which deal with the imposition of a surtax or undistributed profits of a corporation. When it is attempted to draw such inferences, they are usually incorrect and misleading.

It is respectfully submitted that the facts in this particular case bring the Respondent directly within the class of corporations which Congress by the 1942 amendment to the 1936 Revenue Act attempted to relieve from the surtax on undistributed profits—an attempt which is bound to prove successful unless the words of the statute are twisted into something other than their normal meaning.

It follows that the opinion and judgment of the Court of Appeals which affirmed the judgment of the district court in favor of Respondent are correct and that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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FEB 18 1947
CHARLES ELMORE CROPLEY

No. 430

IN THE SUPREME COURT
OF
THE UNITED STATES

OCTOBER TERM, 1946

UNITED STATES OF AMERICA, Petitioner

vs.

OGILVIE HARDWARE COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENT

H. C. WALKER, Jr.,
ELIAS GOLDSTEIN,
Attorneys for Respondent.

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No. 430

IN THE SUPREME COURT
OF
THE UNITED STATES

OCTOBER TERM, 1946

UNITED STATES OF AMERICA, Petitioner

vs.

OGILVIE HARDWARE COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENT

This case presents no issue of fact, as the facts were stipulated. It involves the resolution of disputes on several points of law, all directed at determining the meaning of paragraph (a) (3) of Section 501 of the Revenue Act of 1942, which amended paragraph (3) of

Section 26(c) of the Revenue Act of 1936 relating to credits of corporations, to read as follows:

"(3) Deficit corporations. In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936."

SUMMARY OF THE FACTS

The summary of the facts as set forth in the brief for Petitioner is fair and adequate and, for the purpose only of convenience, we reproduce it here.

> The taxpayer, Ogilvie Hardware Company, Inc., was incorporated under the laws of Louisiana in 1907, with a capital stock of 1,000 shares of common stock of the par value of $100,000 issued and outstanding. It operated a wholesale hardware business in that State on a fiscal year basis, ending on May 31st of each year. (*R. 12-13*).
>
> The surplus of the corporation at the end of the fiscal year ending on May 31st, 1924 was $149,306.43. On July 7, 1924, a one hundred per cent dividend in common stock ($100,000 par value) was issued, share for share, to its common stockholders, which was charged to surplus on the books of the taxpayer during the fiscal year 1925. After charging this dividend to surplus, paying a cash dividend of $14,681, and giving effect to the earnings for the year ending May 31st, 1924, the corporation still had a surplus of $42,229.70. (*R. 13*)
>
> Subsequent to the declaration of the stock dividend, the taxpayer sustained operating losses, and on May 31, 1936, its books disclosed a deficit of $74,875.10. On May 31, 1937, the deficit shown on the books was $71,347.18, and on May 31, 1938 the deficit shown was $60,923.58. (*R.14*)
>
> Upon examination of the taxpayer's income and excess profits returns for the fiscal years ending May 31, 1937 and May 31, 1938, the Commissioner of Internal Revenue made certain adjustments and assessed additional taxes, which were paid by the taxpayer. Of the total taxes paid by the taxpayer

for those periods, $5,426.93 consisted of a surtax on undistributed profits for the fiscal year 1937, and $1,488.86 consisted of a surtax on undistributed profits for the fiscal year 1938. (*R. 15, 16*)

Following the enactment of Section 501 of the Revenue Act of 1942, the taxpayer filed claims for refund of the surtax on undistributed profits in the amounts of $5,426.93 and $1,488.86, for the fiscal years 1937 and 1938, respectively, based on the ground that it had a continuous deficit in accumulated earnings and profits on May 31, 1936, May 31, 1937 and May 31, 1938, which, on each of those dates, exceeded the total amount of its net income for the fiscal years ending with those dates, and that it was thus prohibited by Louisiana law from paying dividends to its stockholders. The Commissioner rejected the claims and thereafter the present suit was instituted to recover these amounts. (*R. 16, 17*)

The district court entered a judgment in favor of the taxpayer for the amount in suit (*R. 27, 28*), and the circuit Court of appeals affirmed (*R. 38*).

SUMMARY OF ARGUMENT

(1) By the 1942 amendment to Section 26(c) of the 1936 Revenue Act, Congress placed on the same footing with regard to liability for surtax on undistributed profits deficit corporations which were forbidden to declare dividends by a state law antedating May 1, 1936, and those which were prohibited from doing so by a written contract antedating May 1, 1936.

This intent on the part of Congress in enacting and on the part of the President in approving this amendment is clear from the plain and unambiguous wording of the statute itself and from the circumstance and the event which brought about the amendment. The circumstance was the obvious injustice to corporations of the class which Congress sought to relieve and the event was the decision of this Court in *Helvering v. Northwest Steel Rolling Mills, 311 U. S. 46*, in which it was held that because of the manner in which the 1936 statute was worded a corporation prohibited by a contract from paying dividends was not penalized and a corporation prohibited by state law from payment of dividends was penalized although other circumstances were identical.

(2) Laws passed by Congress are intended by that body to apply to and to be understood by the people of the United States who speak a common language generally known as the "English" language; and accordingly, unless Congress has specifically indicated a contrary intention, the words used by it in enacting a law should be given their ordinary and common meaning, thus giving effect to the legislative will as expressed in the statute by men who speak the English language and think in terms of that language.

(3) A statute is not open to construction as a matter of course. Where the language of a statute is

plain and unambiguous, as is the case here, the court will not undertake to whittle away or pervert its meaning by construction or interpretation, but will apply the law as it reads to the ascertained facts of a particular case. Words may be tricky things, but they are, in so far as we know, the only medium that has ever been used for the expression of the will of the Legislature by way of a law; and the enactment of a law is the only method by which the legislative will may be made effective. Interpretation of a statute by reference to statements made by committees and individuals prior to its enactment is permissible only when the intent of the Legislature may not be determined from the language of the statute itself.

(4) Where Congress has used the same expression twice in a single paragraph of a law, it will not be presumed that Congress intended to give a different meaning to the expression in one place from what was intended in the other.

(5) A stock dividend lawfully declared in the regular course of business and without intention to avoid or reduce income tax liability converts surplus assets into capital which is no longer available for distribution to stockholders; and where such addition to capital occurred prior to May 1, 1936, it became a part of the capital of the corporation for all purposes, and except in those instances where Congress has specifically otherwise directed it will be considered a part of the corporate capital in relation to income and other Federal taxes.

(6) The opinion of this Court in a particular case should always be read in the light of the facts of that case, and individual statements and expressions of the Court in an opinion may not be plucked out of the content of the opinion as a whole and used as an authority

in another case where the facts are dissimilar and the issues not the same.

(7) Even where an expression in a revenue bill is vague enough to require extrinsic evidence for its proper understanding, the question in such case is not what the Senate intended or what the House of Representatives intended, but what the whole Congress intended. An act of Congress must be passed by both the House and the Senate and must also be approved by the President or passed by a two-thirds vote in both House and Senate over his veto. The report of the Ways and Means Committee of the House on the meaning of a bill is entitled to as much weight as that of the Senate Finance Committee and no more; and a difference of opinion between the two committees as to what they have in mind in recommending tax legislation may not reasonably be resolved by arbitrarily accepting one and ignoring the other.

(8) The Revenue Act of 1936 selected May 1, 1936 as the "good faith" line between contracts prohibiting payments of dividends which were made without relation to the income tax laws and contracts entered into for the purpose of avoiding the surtax on undistributed profits. This same date was kept in mind and used by Congress in amending that portion of the act levying a surtax on undistributed profits of corporations. They first were relieved of the surtax if prohibited by a written contract antedating May 1, 1936 from declaring dividends and were subsequently relieved by the 1942 amendment if prevented from declaring dividends by state law or public regulation antedating May 1, 1936. Where the report of the Ways and Means Committee of the House as to the effect of a section of a revenue act merely gives to the wording of the act its natural significance and where the text of the report of the Senate Finance Committee does the same

thing but in one example given by the Senate Finance Committee another and contradictory meaning is imputed to the section unless it be inferred that the example related to a condition created on or after May 1, 1936, it is proper to give to this example a construction which will harmonize it with the body of the report and with the other examples and with the report of the House Ways and Means Committee on the same section.

(9) A Treasury regulation which conflicts with the act of Congress which it seeks to interpret may not stand, as neither the Constitution nor the laws of the United States have given to any official of the Treasury Department the right to repeal or amend an act of Congress nor to engraft a limitation, a refinement or an unintended meaning upon an act of Congress.

ARGUMENT

We have said that the language used by Congress in enacting Section 501 of the Revenue Act of 1942 is unambiguous. The district judge who heard and studied this case was of this opinion, as were the three judges of the court of appeals. Similarly, the district judge who heard and decided the suit of *United States v. Byron Sash & Door Company, 150 Fed. (2d) 44*, and the three judges of the Court of Appeals for the Sixth Circuit had no occasion to look beyond the statute itself to understand the clear intent of Congress expressed in its enactment.

The decision of the Court of Appeals for the Eighth Circuit in the case of *Century Electric Company v. Commissioner, 144 Fed. (2d) 983*, is authority only for the proposition that where a corporation with a surplus has large current earnings, it cannot convert itself into a deficit corporation by the device of declaring a stock dividend.

The act seemed plain enough to the district judge in the only other case of which we know in which this particular paragraph has been construed and applied. We refer to *Philadelphia Carpet Company v. United States, 68 Fed. Sup. 712.*

This in itself is a pretty fair indication that to plain men interested only in ascertaining the intent and meaning of the statute, it is so worded that it may be understood without extrinsic aid. Of course, the statute itself is the best evidence of its own meaning and that meaning is, we submit, clear enough for anyone who sees it with an unjaundiced eye.

It will be noted from reading Section 501 of the 1942 Revenue Act that it was adopted to retroactively correct the injustice to a large number of corporations

which state laws forbade to declare dividends which injustice became patent after the decision of this Court in *Helvering v. Northwest Steel Rolling Mills*, supra. To the public at large, to members of the House of Representatives, and to members of the Senate, it seemed unfair that relief from the penalty for not distributing current earnings by way of dividends should be extended to corporations prohibited by a contract from making such distribution and denied to corporations which were forbidden to make such distributions by the law of the state or rule of a public regulatory body. Under Section 26(c) (1) of the Revenue Act of 1936, a corporation was entitled to the credit there allowed without regard to its financial status under Federal tax laws; and it has not yet been contended, in so far as we know, that the language of that section should be construed as having a special Federal tax meaning different from that of its ordinary and everyday significance. In order to avoid the penalty for not distributing its current earnings under the 1936 act, a corporation had merely to show that it was precluded by the terms of a valid written contract entered into prior to May 1, 1936 from declaring the dividend. No distinction was drawn by the 1936 act between corporations the capital of which had been derived from original subscriptions only and corporations the capital of which had been in part derived from original subscriptions and in part from the conversion of surplus into capital by the declaration of a stock dividend.

Why, then, should such a distinction be interpolated into the unambiguous language of the 1942 amendment which merely sought to equalize the concessions granted to the corporations prohibited by contract from declaring dividends and those prohibited by a state law?

It has been emphasized in the brief for Petitioner that the court below erred "in holding that the state law is controlling in the determination of whether a corporation is a deficit corporation within the meaning of these provisions of the Federal statute." The statement thus made necessarily assumes a conflict between the state law and the Federal law. In our opinion and in the opinion of the court below, there was no such conflict, as the congressional enactment itself made the state law a part of the test of the right of the taxpayer to claim the surtax exemption.

The exemption is allowed to a deficit corporation if it "is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936." Clearly, the deficit in accumulated earnings and profits referred to by the quoted language is such a deficit as would prevent payment of dividends under a state law in effect prior to May 1, 1936, to which state law one is bound to look both for the prohibition against the payment of dividends and the definition of the conditions under which such prohibition is made effective. If the corporation has a deficit in accumulated earnings and profits as it is defined by the state law and if the state law forbids the payment of dividends during the continuance of the deficit, then the corporation is entitled to the benefit of the exemption. That seems to us to be the meaning of the language which Congress used.

But it is not necessary to go this far in order to justify the construction placed upon the statute by the lower courts. We need take only the common and popular meaning of the words used by Congress—the meaning which is attributed to those words by the

common people of the United States, for whom laws are enacted.

There is no reason for a great pother and stir about the meaning of the term "deficit in accumulated earnings and profits". Certainly "earnings" and "profits" are terms which have general and popular significance and are readily understood by the average man. Those who need enlightenment have but to utilize any one of the standard English dictionaries which are in general use. Similarly, the word "deficit", which is a synonym for "deficiency", is an antonym for "surplus".

A corporation whose operations from a financial standpoint have been such that its outgo has exceeded its income, resulting in a depletion of its capital, is one "having a deficit in accumulated earnings and profits". State laws which provide that dividends may be paid only out of a corporate surplus necessarily prohibit payment of dividends by corporations having a deficit in earnings and profits; for a surplus can be created only out of earnings and profits, and a deficit arises only when the earnings and profits are less than the expenses and the excess of outgo over income must be met by depletion of the capital.

It is urged by the Petitioner that the expressions used by Congress in this section of the 1942 Revenue Act must be taken in a special Federal tax sense and may not be given their ordinary and usual signification. This contention seems to us squarely at odds with accepted canons of construction of statutes by this Court and by courts generally.

In *United States v. Kirby Lumber Company, 284 U. S. 1, 76 L. Ed. 131, 52 S. Ct. 4*, Mr. Justice Holmes, speaking for a unanimous court *in a tax matter*, held that in determining what is gain or profit subject to Federal

income tax, such terms should be given their "plain popular meaning", which is just what the courts below held in this case.

As said by this Court in *United States v. Temple, 15 Otto 97, 26 L. Ed. 967,*

> "Our duty is to read the statute according to the natural and obvious import of the language, without resorting to subtle and forced construction for the purpose of either limiting or extending its operation."[1]

In *Addison v. Holly Hill Fruit Products, 322 U. S. 607, 88 L. Ed. 1488,* this Court said:

> "After all, legislation when not expressed in technical terms is addressed to the common run of men and is, therefore, to be understood according

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Note 1: To the same effect see,

Columbia Water Power Co. v. Columbia Electric Street Railway, etc. Co., 172 U. S. 475, 19 S. Ct. 247, 43 L. Ed. 521;

Southern Railway Co. v. United States, 222 U. S. 20, 32 S. Ct. 2, 56 L. Ed. 72;

United States v. First National Bank, 234 U. S. 245, 34 S. Ct. 846, 58 L. Ed. 1298;

Caminetti v. United States, 242 U. S. 470, 37 S. Ct. 192, 61 L. Ed. 442;

Hammer v. Dagenhart, 247 U. S. 251, 38 S. Ct. 529, 62 L. Ed. 1101;

United States v. Wurts, 303 U. S. 414, 58 S. Ct. 637, 82 L. Ed. 932;

Old Colony Railway Co. v. Commissioner of Internal Revenue, 284 U. S. 552, 52 S. Ct. 211, 76 L. Ed. 484, and authorities cited therein.

to the sense of the thing, as the ordinary man has a right to rely on ordinary words addressed to him."

The general rule is thus stated in *50 Amer. Juris, title "Statutes", Sec. 227:*

> "The only mode in which the will of a legislature is spoken, is in the statute itself. Hence, in the construction of statutes, it is the legislative intent manifested in the statute that is of importance, and such intent must be determined primarily from the language of the statute which affords the best means of its exposition. Indeed, it is the duty of the courts to give a statute the interpretation its language calls for, where this can reasonably be done, and the general rule is that no intent may be imputed to the legislature in the enactment of a law other than such as is supported by the face of the law itself. The courts may not speculate as to the probable intent of the legislature apart from the words. A statute is to be taken, construed, and applied in the form enacted, and so declared, announced, and expounded. Popular demand as to the enforcement of a law adds nothing to, and detracts nothing from, the duty of the court to construe the law as it is. As a reason for these rules, it has been declared that the legislature must be assumed or presumed to know the meaning of words, to have used the words of a statute advisedly, and to have expressed its intent by the use of the words found in the statute."

The emphasis placed throughout the brief for Petitioner upon "the special meaning" which it is claimed the words "earnings" and "profits" and "deficit" have acquired for Federal tax purposes implies that the revenue laws of the United States are not

expressed in language such as the people of the United States in general use but in a tax lingo or dialect which only the initiated—and particularly the people charged with the administration of the revenue laws—can fully understand. We believe that very few congressmen or senators would support this view. Most of them would say that they understand language used in Federal statutes in its natural import and give to it the same meaning as they would give to the same language used elsewhere. So-called "tax experts" pay, we venture to say, only a very tiny percentage of the taxes levied by the United States; and it does not appear reasonable to us to assume that Congress, which is elected by the common people of the United States, would in legislating upon a subject which vitally and immediately affects the wellbeing and the financial status of the great majority of the people of the United States as income taxation does would employ terms which the people who have to pay the tax would not understand unless and until interpreted for them by these tax experts. We are not among those who believe that income tax legislation has a language of its own exclusive and apart from the common understanding of the words which frequently occur in the revenue laws.

We submit on this point that Section 501 of the Revenue Act of 1942 does not require interpretation because it is not ambiguous and because its meaning is clear without interpretation.

Adopting these principles of construction and giving to the words used in Section 501 of the Revenue Act of 1942 their ordinary and common meaning, and applying the statute to the stipulated facts one is, we think, bound to conclude that the judgment of the two lower courts in this case is correct; for that the respondent was in good faith and declared the stock dividend in 1924 in accordance with sound business practices is

not disputed and the stipulation of facts shows that at the end of its fiscal years ending May 31, 1937 and May 31, 1938 the taxpayer had a large deficit; and the Louisiana statute, in unmistakable terms, prohibits payment of dividends by any corporation where the effect of such payment would be the diminution of the capital; and certainly a corporation which has a large deficit instead of a surplus at the end of its fiscal year cannot pay a dividend except out of what is left of its capital.

The Petitioner attempts to avoid this conclusion by separating the capital of the respondent into two parts, one being that which was originally subscribed and the other being the addition to the capital as a result of the stock dividend declared in 1924. As to the latter, the Petitioner assigns to it an amorphous character as both capital and surplus and contends that although for other purposes it was merged into and became a part of the new capital of the corporation, for the purpose of the question involved here it remained a part of the surplus. Petitioner argues accordingly that treating the half of the capital which was added in 1924 not as capital but as surplus has the effect of transforming the respondent from a corporation with a deficit to a corporation with a surplus and thus deprives it of the protection which Congress in the 1924 Revenue Act extended to corporations prohibited by state law from declaring dividends.

The argument thus made is unsound unless hitherto universally accepted principles of the law of corporations be discarded.

In *Fletcher Cyc. Corp., Perm. Ed., Vol. II, Title "Stock and Stockholders", Chap. 5362,* the general rule is thus succinctly stated:

"A stock dividend converts surplus assets into capital."[2]

In *Green v. Bissell*, 79 Conn. 547, 65 Atl. 1056, 8 L. R. A. (N. S.) 1011, the Supreme Court of Connecticut held that,

"The declaration of a stock dividend involves the creation and issue of new shares of stock. The basis of the issue, in so far as payment into the corporation is required of the recipient, is surplus

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Note 2: Among the authorities cited to support the text are,

Equitable Trust Co. v. Prentice, 250 N. Y. 1, 164 N. E. 733;
Harding v. Staples, 111 Ken. 325, 140 Atl. 846;
Green v. Bissell, 79 Conn. 547, 65 Atl. 1056, 8 L. R. A. (N. S.) 1011; 118 Am. St. Rep. 156, 9 Ann. Cas. 287;
Bryan v. Aikin, 10 Del. Ch. 1, 82 Atl. 817;
In re Joy's Estate, 247 Mich. 418, 225 N. W. 878;
Lamb v. Lehmann, 110 Ohio St. 59, 143 N. E. 276;
In re Estate of Heaton, 89 Vt. 550, 96 Atl. 21, L. R. A. 1916A 201;

to which list we add,

Eisner v. Macomber, 252 U. S. 189, 64 L. Ed. 521;
Commissioner v. Cordingley, 78 Fed. (2d) 118 (1st cir.);
Petty v. Helvering, 98 Fed. (2d) 717, (2nd cir.);
Commissioner v. Champion, 78 Fed. (2d) 513 (6th cir.);
Commissioner v. Quackenbos, 78 Fed. (2d) 156 (2nd cir.);
Commissioner v. Ahlborn, et al., 77 Fed. (2d) 700 (3rd cir.).

assets which thus become converted into strict capital with all which that implies.";

and in *Lamb v. Lehmann, 110 Ohio St. 59, 143 N. E. 276,* the Supreme Court of Ohio said,

> "A declaration of a so-called stock dividend has no other effect, so far as the corporation itself is concerned, than to carry the position of the surplus covered by such stock dividend into the permanent capital account, thereby placing it beyond the power of the Board of Directors to withdraw it from corporate use and distribute to stockholders.";

and in *In re Estate of Heaton, 89 Vt. 550, 96 Atl. 21, L. R. A. 1916A 201,* the Supreme Court of Vermont declared that,

> "Such a dividend operates to transfer distributable assets to the individual ownership of the stockholders, thus changing accumulated surplus into permanent capital, and thereby creating an additional liability of the corporation."

In *Eisner v. Macomber, 252 U. S. 189, 64 L. Ed. 521,* this Court said:

> "A 'stock dividend' shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. *Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer as available for actual distribution.*" (*Emphasis ours.*)

All of the cases which we have cited on this point hold the same way; so there is nothing to be gained by

piling quotation on quotation to prove that when the respondent transferred $100,000 from its surplus to its capital account in 1924 by declaring a stock dividend, its capital thereafter was $200,000 whereas before it had been $100,000; and this $200,000 was its capital for all purposes—not merely for some. This stock dividend was declared by the respondent many years before Congress levied a tax upon undistributed profits. It was a corporate act done in good faith for a strictly business purpose and had no relation to the avoidance or reduction of Federal income taxes. There is, it seems to us, no logical basis for the attempted distinction between the capital originally subscribed and the addition made to it in 1924.

In the case of *United States v. Byron Sash & Door Company, 150 Fed. (2d) 44*, in which the same contention was advanced that is here made, the Court of Appeals for the Sixth Circuit in a powerfully reasoned decision thus rejected the contention:

> "The Commissioner's contention is based upon the ground that the taxpayer's deficit was the result of the $130,000 non-taxable stock dividend declared in 1929. It is argued that, since non-taxable stock dividends do not affect or diminish earnings and profits, they, therefore, cannot cause a deficit, and that there was in this case, therefore, no deficit in the taxpayer's accumulated earnings or profits. * * * * * *"

The court then refers to the argument of the Commissioner that,

> "Because the foregoing section provides that a stock dividend, like that in this case, shall not be considered a distribution of earnings or profits, it is urged that such a dividend cannot cause a deficit in

earnings and profits, and that, consequently, a corporation whose deficit on its books results from a distribution of tax-free stock dividends may not, within the meaning of the statute, have the benefit of the credit granted by Section 501 of the Revenue Act of 1942."

Then the court pointed out what the Commissioner had overlooked; and what it said is just as applicable to this case as to the case before it.

"Appellee does not claim that the distribution of the stock dividends was a distribution of the company's earnings and profits. On the contrary, it is maintained that there never was any such distribution, but rather that the earnings and profits were capitalized by the act of the corporation in transferring them to its capital account and were no longer available for distribution to stockholders. It is submitted by appellee that by the action of the corporation, the earnings and profits became, as of the time of the declaration of the dividend, merged and coalesced with the capital, and became subject to all the limitations imposed by law upon corporate capital.

"Section 115 (h) deals with the taxable status of the stockholder who receives stock dividends, rather than with the liability of the corporation for tax, and to use this provision of the statute in order to ignore the deficit in the case before us, and to deny credit on undistributed profits surtax to this corporation, seems untenable."

Similarly, the Fifth Circuit of Appeals in this case thus concluded:

"If the deficit of this Company had been caused directly by a stock dividend, as the language

of the court in Century Electric Co. vs. Commissioner, supra, indicates the court there thought, we might agree that the Company could not secure the credit by such an act. But the stock dividend here was lawfully accomplished in 1924, twelve years before this surtax on undistributed profits ever existed. Since 1924 this $100,000 has from the corporate standpoint been irrevocably taken out of distributable earnings and profits, or surplus, and has been capital, which could not according to the law recognized in Eisner vs. McComber, supra, and all the authorities, be distributed to shareholders unless on due proceedings to reduce the capital stock. There was then left a substantial surplus. This was lost and the deficit created in the depression years by operating losses. We hold this corporation was entitled to the credit against surtax in the tax years here involved, and the judgment is affirmed."

It is said in the brief for Petitioner that the report of the Senate Committee on Finance on Section 501 of the 1942 Revenue Act is unambiguous and that a reference to it clearly shows that it was never the intent of Congress to construe the section as it has been construed by the two lower courts. Because the law itself is clear, it should be superfluous to examine these reports; but the point is substantially all that Petitioner has to go on, and because of that fact we will undertake to show the unsoundness of the deductions drawn by Petitioner from the report. We do not get from this report the same impression as does Petitioner; and we are certain that it is anything but unambiguous. In fact, it is self-contradictory in that the text reads one way and *one* of the six illustrations given reads the other.

The report on the same section of the Ways and Means Committee of the House uses a different illustration, which is entirely consistent with the wording of the section itself (77th Congress, Second Session, Report No. 3333 accompanying HR 7378, page 170).

Let us first consider the report of the Senate Finance Committee, eliminating that portion which relates to a stock redemption credit and which is, therefore, not relevant to our discussion here. In one paragraph of the text of the report it is said:

> "Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax at various rates from 7 to 27 percent of their undistributed net income. In some instances State law or an order of a public regulatory body prohibited payment of dividends during the existence of a deficit even though the corporation had current earnings and profits which would constitute undistributed net income under the definition thereof in section 14 (a) (2). Such corporations were, therefore, subject to undistributed profits surtax even though they were prohibited by law from paying dividends. The addition of the new paragraph 3 to subsection (c) of section 26 to provide an additional credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year is intended to give relief in certain of these cases."

This accords with the meaning of the words used in the law. The Senate Finance Committee illustrated the application of deficit credits by six examples, only one of which (No. 2) is at variance with the meaning of the amendment as we read it. The other five are examples of how the amendment works out when their

natural and common meaning is given to the words of the statute.

It may well be that what the Senate Finance Committee had in mind in making use of example No. 2 was a deficit caused by a prior capitalization of surplus in the course of a nontaxable reorganization which took place subsequent to May 1, 1936, in which case the example will be wholly consistent with the statute. Nothing is said in the example about May 1, 1936; but it is not to be supposed that the Senate Finance Committee deliberately recommended the adoption of this amendment and then illustrated its application by even one out of six examples which is not a logical sequence of the language used in framing the law.

The assumption that example No. 2 in the Senate report referred to a nontaxable reorganization dating subsequent to May 1, 1936 is strengthened by a careful reading of the report of the House Ways and Means Committee. The House report in simple language, like the amendment itself, says that the act "grants relief from the undistributed profits tax for taxable years beginning after December 31, 1935 and prior to January 1, 1938 in certain cases by allowing an additional credit in computing undistributed net income for the portion of the adjusted net income which could not be distributed as a taxable dividend"; and it illustrates the application of the tax by two examples, neither one of which indicates in the slightest that it was the intention that the words of the amendment should be construed in any sense other than their natural, ordinary and common sense. A reading of the two examples given by the Ways and Means Committee of the House shows that that committee at least had in mind granting of relief to corporations which were prohibited by state law or public regulation from paying dividends to the same extent as such relief had

been granted by the 1936 Revenue Act to corporations which were prohibited by a prior written contract from declaring dividends.

The first example used by the House Committee deals with a corporation which by reason of its financial condition is forbidden by state law from declaring a dividend and the second example deals with corporations which without regard to their financial status are forbidden by a written contract to declare dividends. Both are placed in the same category and in each case it is pointed out by the Committee that there would be no liability for any undistributed profits tax.

We have, then a case where the report of the Senate Finance Committee is ambiguous and contradictory unless it be assumed that example No. 2 related to a nontaxable reorganization occurring subsequent to May 1, 1936, while the Ways and Means Committee of the House in its report shows no inconsistency and takes the statute just as it reads and gives the words their ordinary effect in the two examples which it employs.

From this it follows that either a choice must be made between the intention of Congress as set forth in the Senate report and that same intention as set forth in the House report, which would require the Court to take in quite a bit of legislative territory, or the two reports must be reconciled by assuming that example No. 2 given in the Senate report refers to reorganizations subsequent to May 1, 1936 or neither report need be taken into consideration in construing what appears to have been generally accepted as an unambiguous amendment of the revenue laws.

It seems to us that under these circumstances the indicated course is that followed by the courts below, which looked to the act itself and found no difficulty in determining from that source alone what was the intention of Congress in adopting it.

Review of the Argument Made and Statutes and Authorities Cited in Petitioner's Brief.

Such a glittering heap of judicial decisions, Treasury regulations, statutory references and plausible argument is found in the brief for Petitioner that a close examination is justified to separate the gold from the dross and the appearance from the reality. The decisions cited appear to us to mainly fall into three groups. Group A embraces decisions in which dividends were held taxable if declared out of earnings since February 28, 1913.

Since the adoption of Section 115 (a) of the Internal Revenue Code by the Revenue Act of 1936, discussion of this point is academic, for in that section Congress declared that all dividends received which were paid out of earnings of a corporation since February 28, 1913 should be taxable to the recipient. The power of Congress to thus tax dividends has not been questioned and the issue is not in this case. It is interesting to note that prior to 1936 it was generally held in the very decisions which are cited by Petitioner that earnings which *in good faith and for a proper business purpose* were capitalized by means of a stock dividend became capital of the corporation for all purposes, including the application of the Federal income tax laws.

For instance, in *Patty v. Helvering, 98 Fed. (2d) 717*, decided July 18, 1938 by the Circuit Court of Appeals for the Second Circuit, one of the questions here was the issue on which the decision turned.

> "The taxpayer says that stock dividends by impounding the earnings turn them into capital, and make § 115(b) inapplicable: the Commissioner, that they leave earnings unaffected for taxing purposes.";

and this is what Judge Learned Hand, speaking for a unanimous court, said:

> "Congress might have taxed any earnings of a company when they were distributed to the shareholders, whether or not they were in 'liquidation' of outstanding shares. They are income, and the fact that shares have been issued against them and impound them, so as to prevent their distribution, is not material under the Sixteenth Amendment, U. S. C. A. Const. Amend. 16. Nevertheless, the character of a stock dividend for all other purposes then taxation depends upon the local law; substantially upon how far the state of incorporation regards a company's capitalization as an assurance to its creditors; such a dividend takes the earnings out of the control of the company and impounds them until dissolution or cancellation of the shares. To treat the earnings as still earnings is to disregard this, and would indeed postpone liquidation of a company until after its subscribed capital began to be distributed. In the case of old companies, which have saved and invested their earnings, this would often be hard to apply. For example, if their capital had become impaired, and they had used earnings to make up the deficit, it would be a strong doctrine to hold that even these remained taxable; yet there seems to be no less reason for doing so than for denying them the quality of capital when a stock dividend has been issued against them. We do not believe that people regard earnings as maintaining their character in such cases; certainly not when the shares have a par value. Rather, the share increase is thought of as absorbing them just as an original issue absorbed its subscription price; all the capitalized assets are capital regardless of their source. Congress must have used the words of section 115 in this, their usual sense."

Other cases of this type are

Beretta v. Commissioner, 141 Fed. (2d) 452;

Chapman Price Steel Co. v. Commissioner, 146 Fed. (2d) 189;

Commissioner v. Ahlborn, 77 Fed. (2d) 700;

Commissioner v. Champion, 78 Fed. (2d) 513;

Commissioner v. Estate of Bedford 325 U. S. 283;

Commissioner v. Cordingley, 78 Fed. (2d) 118;

Commissioner v. Quackenbos, 78 Fed. (2d) 156;

and others too numerous to be individually reviewed.

The second class of cases is those in which it has been held that a court will look into the legislative history of a doubtful and ambiguous statute and will even attach great importance to a long standing interpretation by the Executive Department of such a statute. This is a doctrine which no one disputes. We do not undertake even to list these cases. They are aptly represented by the decision of this Court in *Edwards v. Douglas, 269 U. S. 204, 70 L. Ed. 235,* in which it was held that,

> "Enquiries into the details of legislative history are sometimes helpful in removing a doubt presented by the language used in a statute."

It may be remarked that in the same case the court declined to resort to that aid because the meaning of the statute was plain from its context and needed no further illumination, as is the case here.

We have not contended that the history of legislative proceedings should not be examined when the words of a statute are doubtful; but we do say that when the words of the statute are clear, as here, and its

meaning plain without such extrinsic aid, the generally approved rule is that the court will look to the statute for its meaning and will apply it as it is written.

The third class of cases is composed of those which when considered in relation to their facts and the questions presented are without relevancy here. Outstanding examples of this type of case are two on which the Petitioner leans heavily, one being the recent decision of this Court in *Commissioner of Internal Revenue v. Estate of Bedford, 325 U. S. 283, 98 L. Ed. 1011*, which held exactly what is stated in paragraph five of the Law Edition syllabus.

> "A sum of money received by a stockholder of a corporation in exchanging old stock for new on a recapitalization is, if paid out of earnings and profits, taxable as income rather than as a capital gain."

In the Bedford case the reorganization took place in 1937; and the essential facts were that the Bedford estate received not only new stock but cash as a result thereof. The court held that the new stock was not taxable as income but that it having been shown that the cash received was cash paid from earnings accumulated since February 28, 1913, it constituted a dividend to the Bedford estate and was taxable as ordinary income. The expressions used by the court in its opinion are applicable to the facts in that case; but the difference between the facts in that case and in the case at bar is so wide that nothing said in the decision can help this Court to decide this particular case.

The same observation is true of the decision in *Commissioner v. Wheeler, 324 U. S. 542, 89 L. Ed. 1166.* That case involved the construction of Section 501 (a) of the Revenue Act of 1940, which deals wholly with

"the gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation." It will be noted that here, as in all other parts of the various revenue acts, whenever Congress wished to make the act applicable to conditions going back to February 28, 1913, it plainly so stated in the act itself.

In the Wheeler case this Court sustained the Commissioner and the tax court as against the court of appeals, and held that the regulation of the Commissioner under which the deficiency was assessed was valid because it corresponded to Section 501 of the second Revenue Act of 1940. Here again the court made statements which have definite relation to the facts in the case before it then but which are not apropos here.

If argument before this Court is to be resolved into a parade on each side of observations and statements made by the court in cases where the facts and issues were dissimilar, the exposition might be interesting but it seems to us it would be of very little value to the court.

It is said in the brief for Petitioner that the phrase "earnings and profits" has a long history in the Federal statutes and that it is no longer open to doubt that the term has a special meaning in the Federal tax sense. An examination of the congressional statutes will show that the term "earnings and profits" was uniformly used by Congress in the income tax statutes in the same sense that ordinary people would give to the words in ordinary commercial affairs. Whenever Congress has intended that "earnings and profits" should mean earnings and profits since February 28, 1913 or has intended that it should mean anything other than the natural and ordinary sense of the words used, it will be found that Congress has expressly so said.

At the top of page 12 of the brief for Petitioner appears reference to Sections 26 (c) (2), (e) and (f), 27 (f), 102 (a), 112 (c) (2), 115 (a), (b), (c), (e), (g), (h) and 351 of the Revenue Act of 1936, which sections are referred to as examples of the use by Congress of the term "earnings and profits" in a special tax sense. Similarly, it is said that the phrase "deficit in accumulated earnings and profits" is used in Section 27 (a) (3) of the Revenue Act of 1938.

We have read each of the sections of the two revenue acts referred to except Section 351 of the Revenue Act of 1936, which we did not find in the act; and the conclusion is irresistible that Congress did not use these terms in any special sense but used them in exactly the same sense in which they were understood by the taxpayer and by the two courts below. It is further clear that any departure from the ordinary and common meaning of the words when so intended by Congress is specifically set forth in the taxing statutes. For example, Section 26 (c) (2) of the Revenue Act of 1936 refers twice to earnings and profits, and both times the words are given their ordinary and natural meaning. The same thing is true of Section 26 (f), Section 27, Section 102 (a), Section 115 (c), (e), and Section 115 (h).

Let us now look at the other sections which are referred to in Petitioner's brief and see if in every instance where Congress referred to "accumulated earnings and profits" and meant profits and earnings accumulated since February 28, 1913 it did not expressly say so.

In Section 27 (f) of the 1936 act the reference is to "the earnings or profits accumulated after February 28, 1913". In Section 112 (c) (2) certain gains were taxed as dividends in an amount "not in excess of his ratable share of the undistributed earnings and profits

of the corporation accumulated after February 28, 1913". In Section 115 (a) dividends are defined as distributions made "(1) Out of its earnings or profits accumulated after February 28, 1913, or (2) out of earnings or profits of the taxable year." In Section 115 (g) it was provided that "to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913 shall be treated as a taxable dividend."

We think that the theory that language was used in a special tax sense by Congress in referring to earnings and profits or deficit in accumulated earnings and profits lacks factual basis. These terms have been frequently employed by Congress in revenue acts and they are employed with equal frequency by businessmen, lawyers, economists, accountants, bookkeepers, storekeepers and practically everyone else who either operates a business or is interested in the result of such operation. It is not necessary to give the congressional use of these terms any specialized tax meaning in order for them to be read and understood by lawyer or layman; and we submit that there is no occasion here for interpreting them in any way other than as did the court of appeals in its outstandingly able opinion.

There are many other arguments made in the brief for Petitioner which we should like to discuss; but this brief is already too long and we therefore turn immediately to our last point, which concerns the force and effect of the Treasury regulations.

This is not a case where Congress has given to the Commissioner any power to change, alter or affect the character of the relief which it has extended to the corporations caught between the Federal mandate to distribute profits on the one hand and the state prohibition against such distribution on the other. If the

meaning of the law were doubtful—if the terms used were ambiguous and hard to understand, an occasion would be presented for a reasonable interpretation by the Petitioner which might be approved by this Court; but those elements are not present in this situation. We deem it unnecessary to cite authorities to sustain our contention that a regulation of the Petitioner which conflicts with the congressional enactment is void.

It is respectfully submitted that the judgment of the court of appeals is correct and should be affirmed.

Respectfully submitted.

H. C. WALKER, Jr.
ELIAS GOLDSTEIN,

Attorneys for Respondent.

APPENDIX

Report of the Committee on Finance, United States Senate, 77th Congress, Second Session, on Section 501 of the Revenue Bill of 1942:

"Section 501. Additional Credits For Undistributed Profits Tax.

"This section is the same as in the House bill, except that a new paragraph to section 26 (c) has been added, providing for an additional credit in cases of corporations having a deficit in accumulated earnings and profits and prohibited by law from paying dividends, and except that a new subsection has been added providing for a stock redemption credit.

"Section 501 amends section 14 (a) (2) of the Revenue Act of 1936, relating to the definition of undistributed net income, and section 26 of that act, relating to credits of corporations, and grants relief from the undistributed-profits tax for taxable years beginning December 31, 1935, and prior to January 1, 1938, by allowing as an additional credit in computing undistributed net income the portion of the adjusted net income which, in certain instances, could not be distributed as a taxable dividend. Relief is also granted in the situation where, for example, the Y corporation in February, 1936, sold stock upon condition that the proceeds of the sale be used to retire certain preferred stock, and could not secure any deduction for the amount so used in computing its undistributed-profits tax. To the extent that the amounts paid may have been a dividend under section 27 (f) of the Revenue Act of 1936, no credit could be allowed since the distribution was a preferential dividend under section 27 (g) of that act. The sale and retirement were consummated prior to the President's message of March 3,

1936, to Congress which was the first suggestion of an indistributed-profits tax applicable to the year 1936. After the enactment of the undistributed-profits tax the corporation did not have sufficient assets remaining which could be used to make distributions so as to prevent the application of such tax.

"Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax at various rates from 7 to 27 percent of their undistributed net income. In some instances State law or an order of a public regulatory body prohibited payment of dividends during the existence of a deficit even though the corporation had current earnings and profits which would constitute undistributed net income under the definition thereof in section 14 (a) (2). Such corporations were, therefore, subject to undistributed profits surtax even though they were prohibited by law from paying dividends. The addition of the new paragraph 3 to subsection (c) of section 26 to provide an additional credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year is intended to give relief in certain of these cases.

"Also under section 14 of the Revenue Act of 1936, it was possible that the undistributed net income of a corporation might exceed accumulated and current earnings and profits. In such case the tax could not be avoided even if distributions were made to shareholders. This result was primarily due to the fact that section 117 (d) of the Revenue Act of 1936 limited capital losses to $2,000 and section 27 (a) and (b) operated to disallow any credit where a distribution did not constitute a taxable dividend. Section 115 of the act provided that the term 'dividend' means a distribution from

earnings or profits, either those accumulated after February 28, 1913, or those realized during the current taxable year. The purpose of the undistributed profits tax was to force the payment of taxable dividends. Where a corporation has no earnings or profits, it cannot make a taxable distribution which would constitute a dividend allowable as a dividends-paid credit in computing the undistributed net income subject to the surtax.

"The application of the deficit credits provided by these amendments may be illustrated by the following examples:

"(1) The X corporation for the calendar year 1936 had an adjusted net income of $200,000 but had a deficit in accumulated earnings and profits as of the close of the preceding calendar year of $20,000. By reason of a State law in effect prior to May 1, 1936, with respect to deficit corporations, only $180,000 of this adjusted net income could be distributed as dividends. Under section 14 of the Revenue Act of 1936, X corporation would be subject to undistributed-profits surtax on $20,000 even though it paid out the entire amount which it could have distributed without violating the State law—namely, $180,000, as taxable dividends. Under the amendment to section 26 (c), X corporation would be allowed a credit of $20,000, and would not be liable for any undistributed-profits tax for the calendar year 1936.

"(2) Assume in the above example that the deficit in accumulated earnings and profits is $20,000 for income tax purposes, but the deficit in accumulated earnings and profits on the corporation's books by reason of a prior capitalization of surplus in the course of a nontaxable reorganization

amounts to $250,000. In this case, although the State law would probably prohibit payment of any dividends, the credit allowed under the amendment to section 26 (c) is limited to $20,000, which is the deficit in accumulated earnings and profits for income tax purposes. X corporation, therefore, will be liable for undistributed profits surtax on $180,000 of its adjusted net income.

"(3) If in the example (1) above there was in addition to the deficit of $20,000, a contract prohibiting the payment of dividends in excess of $150,000, under the existing paragraph (1) of Section 26 (c) the corporation would be entitled to a credit of $50,000, that being the amount of adjusted net income in excess of the net income which may be distributed without violating the contract. Since the credit of $50,000 allowable under paragraph (1) is greater than the credit of $20,000 allowable under paragraph (3) in the section as amended, the former credit is the one to be used as provided in amended paragraph (4).

"(4) The X corporation for the calendar year 1936 had a gross income of $300,000, miscellaneous deductions of $98,000, and capital losses of $100,000, but only $2,000 of the capital losses were deductible due to the provisions of section 117 (d) of the Revenue Act of 1936. Its adjusted net income was therefore $200,000 ($300,000 less $98,000 less $2,000) while its earnings or profits were $102,000 ($300,000 less $98,000 less $100,000). Assuming that the X corporation had no accumulated earnings or profits as of the beginning of the calendar year 1936 and in 1936 paid the entire amount it could distribute as taxable dividends, namely, $102,000, its undistributed net income subject to tax under section 14 of the Revenue Act

of 1936 would be $98,000. Under subsection (f) of this amendment the X corporation would be allowed an additional credit of $98,000, the amount by which the adjusted net income of $200,000 exceeded the earnings and profits of the taxable year of $102,000, and would not be liable for any undistributed profits tax for the calendar year 1936.

"(5) If in the above example there was a contract in existance prior to May 1, 1936, under which the X corporation could not distribute dividends in excess of $150,000 during the calendar year 1936, section 26 (c) (1) of the Revenue Act of 1936 is applicable and allows a credit of $98,000, namely, an amount equal to the excess of the adjusted net income, $200,000, over the aggregate of the amounts which can be distributed within the taxable year as dividends, $102,000. Accordingly, the new deficit credit is unnecessary in such a case, as the X corporation would not be liable to any undistributed-profits tax for the year 1936 under existing law.

"(6) Assume in example (4) that X corporation had a deficit of $20,000 in accumulated earnings and profits as of the close of the calendar year 1935, and the State law prohibited dividend distributions during the existence of a deficit in accumulated earnings and profits. X corporation distributed only $82,000 as taxable dividends, that being the total amount which was available for distribution by reason of the capital losses and the prohibition of the State law. In addition to the deficit credit of $98,000 provided in this amendment by subsection (f), paragraph (3) of section 26 (c) of this amendment provides a credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year or, in this case, $20,000.

Thus corporation X by distributing as taxable dividends the sum of $82,000 would be relieved from payment of undistributed-profits surtax.

"The section contains a provision permitting the refund or credit with interest of any overpayment for the taxable years involved to the extent resulting from the application of the section, if claim is filed within 1 year from the date of enactment of this act. Such refund or credit is to be made notwithstanding the fact that some other provision of law or rule of law (other than compromise)—for example, statute of limitation, closing agreement, board decision, or rule of res judicata, etc.— would, on the date of enactment of this act, or within 1 year from such date, prevent such refund or credit."

* * * * *

Report of the Committee on Ways and Means of the House of Representatives of the United States, 77th Congress, Second Session, on Section 501 of the Revenue Bill of 1942:

"Section 501. Additional Credit for Undistributed Profits Tax.

"This section amends section 14 (a) (2) of the Revenue Act of 1936, relating to the definition of undistributed net income, and section 26 of that act, relating to credits of corporations, and grants relief from the undistributed profits tax for taxable years beginning after December 31, 1935, and prior to January 1, 1938, in certain cases by allowing an additional credit in computing undistributed net income for the portion of the adjusted net income which could not be distributed as a taxable dividend.

"Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax

at various rates from 7 to 27 percent of their undistributed net income, even though such income was in excess of accumulated and current earnings or profits. In such a case the tax could not be avoided even if distributions were made to shareholders. This result was primarily due to the fact that section 117 (d) of the Revenue Act of 1936 limited capital losses to $2,000 and section 27 (a) and (h) operated to disallow any credit where a distribution did not constitute a taxable dividend. Section 115 of the act provided that the term 'dividend' means a distribution from earnings or profits either those accumulated after February 28, 1913, or those realized during the current taxable year. The purpose of the undistributed profits tax was to force the payment of taxable dividends. Where a corporation has no earnings or profits, it cannot make a taxable distribution which would constitute a dividend allowable as a dividend credit in computing the undistributed net income subject to the surtax.

"The application of the deficit credit provided by this amendment may be illustrated by the following examples:

"(1) The X corporation for the calendar year 1936 had a gross income of $300,000, miscellaneous deductions of $98,000, and capital losses of $100,000, but only $2,000 of the capital losses were deductible due to the provisions of section 117 (d) of the Revenue Act of 1936. Its adjusted net income was therefore $200,000 ($300,00 less $98,000 less $2,000) while its earnings or profits were $102,000 ($300,000 less $98,000 less $100,000). Assuming that the X corporation had no accumulated earnings or profits as of the beginning of the calendar year 1936 and in 1936 paid the entire amount it could

distribute as taxable dividends, namely, $102,000, its undistributed net income subject to tax under section 14 of the Revenue Act of 1936 would be $98,000. Under this amendment the X corporation would be allowed an additional credit of $98,000, the amount by which the adjusted net income of $200,000 exceeded the earnings and profits of the taxable year of $102,000, and would not be liable for any undistributed profits tax for the calendar year 1936.

"(2) If in the above example there was a contract in existence prior to May 1, 1936, under which the X corporation could not distribute dividends in excess of $150,000 during the calendar year 1936, section 26 (c) (1) of the Revenue Act of 1936 is applicable and allows a credit of $98,000, namely, an amount equal to the excess of the adjusted net income, $200,000, over the aggregate of the amounts which can be distributed within the taxable year as dividends, $102,000. Accordingly, the new deficit credit is unnecessary in such a case, as the X corporation would not be liable to any undistributed profits tax for the year 1936 under existing law.

"The section contains a provision permitting the refund or credit with interest of any overpayment for the taxable years involved to the extent resulting from the application of the section, if claim is filed within 1 year from the date of enactment of the bill. Such refund or credit is to be made notwithstanding the fact that some other provision of law or rule of law (other than compromises), e.g., statute of limitations, closing agreement, Board decision, or rule of res judicata, etc., would, on the date of enactment of the bill, or within 1 year from such date, prevent such refund or credit.

FILE COPY

No. 430

IN THE SUPREME COURT
OF
THE UNITED STATES

OCTOBER TERM, 1946

UNITED STATES OF AMERICA, Petitioner

vs.

OGILVIE HARDWARE COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

FIRST SUPPLEMENTAL BRIEF FOR RESPONDENT

H. C. WALKER, Jr.,
ELIAS GOLDSTEIN,
Attorneys for Respondent.

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FIRST SUPPLEMENTAL BRIEF FOR RESPONDENT

Since filing our original brief in this case, we have learned that the Report of the House Committee on Ways and Means did not deal with Section 501 of the 1942 Revenue Bill as adopted by both houses. It

follows that the suggestion in our original brief as to a conflict between the report of the House Ways and Means Committee and that of the Senate Finance Committee lacks merit and is withdrawn.

The situation as we now understand it is that an ambiguous and self-contradictory report of the meaning of Section 501 was made to the Senate by the Senate Finance Committee and no report on the subject was made to the House, the members of which would naturally understand Section 501 to mean just what it says.

We stand upon the position originally taken by us and sustained by both of the lower courts that Section 501 of the Revenue Bill of 1942 is clear and unambiguous and should not be interpreted or construed so as to give it a meaning other than that which follows from the ordinary meaning of the words used in the statute.

We again emphasize that even if a reference to the Report of the Senate Finance Committee with regard to the meaning of a clearly expressed section of the revenue bill be of more than academic interest, the text of that report does not in any way conflict with the wording of the statute. See pages 33 through the first paragraph on page 35 of our original brief.

Of the illustrations of the application of the deficit credits which follow the text of the report, as we pointed out in our original brief, only the second illustration may be construed as being in conflict with the text of the report and the wording of the law itself;

and there is no explanation of why the author of Example No. 2 was permitted to write it into the report. It may be, as suggested in the brief of one of the amici curiae that the author of Example No. 2 which was included in the Report of the Senate Finance Committee may have had in mind the particular kind of nontaxable reorganization which was considered by this Court in *United States v. Phellis*, *257 U. S. 156*, *66 L. Ed. 180*, and *Cullinan v. Walker*, *262 U. S. 134*, *67 L. Ed. 906;* but we do not rest our own argument upon that premise.

It seems to us plain that except for Example No. 2 the entire Report of the Senate Finance Committee is a logical and orderly explanation of what Congress was trying to accomplish and what we think it did accomplish by the passage of Section 501 of the Revenue Bill of 1942. Example No. 2 is wholly inconsistent with the purpose of Congress as thus expressed, the meaning of the law and the remainder of the Report of which it is a small part. We do not think the tail should be permitted to wag the dog in this particular case, and since Example No. 2 is reconcilable neither with the balance of the long report of the Senate Finance Committee nor with the controlling language of the amendment adopted following that report, we submit that the greatest effect that can be reasonably given to it is to conclude that its use makes the report ambiguous and impossible of acceptation without ignoring or rejecting either the second example or the balance of the report.

Certainly this is true: The intention of Congress to grant relief to corporations situated just as was the respondent here is so evident from the context of the report as well as from the unambiguous language of Section 501 of the Revenue Bill of 1942 that a single example out of six which conflicts with that intent and would largely prevent that intent from being accomplished should not be accepted as the sole guide for construing the law while the remainder of the report and the words of the law itself are given no weight.

Respectfully submitted.

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ELIAS GOLDSTEIN,
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FILE COPY

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BRIEF OF AMICUS CURIAE, THE VAUGHN MACHINERY COMPANY.

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PRELIMINARY STATEMENT 1

QUESTION PRESENTED 2

ARGUMENT 2

IF A CORPORATION ISSUES A NONTAXABLE STOCK DIVIDEND AT A TIME WHEN IT HAS A SURPLUS, AND SUBSEQUENTLY A DEFICIT IS CREATED BY OPERATING LOSSES, THAT CORPORATION IS A "DEFICIT CORPORATION" WITHIN THE MEANING OF 26(c)(3) OF THE REVENUE ACT OF 1936 AS ADDED BY SECTION 501 OF THE REVENUE ACT OF 1942..... 2

POINT (1)

The phrase: "deficit in accumulated earnings and profits" is plain and unambiguous and may not be limited to deficits arising in a particular manner.

POINT (2)

Since the language of Section 501 of the Revenue Act of 1942 is clear and unambiguous, it requires no reference to extraneous aids for its construction 6

POINT (3).

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In the Supreme Court of the United States

No. 430.

OCTOBER TERM, 1946.

UNITED STATES OF AMERICA,
Petitioner,

vs.

OGILVIE HARDWARE COMPANY, INC.,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE FIFTH CIRCUIT.

BRIEF OF AMICUS CURIAE, THE VAUGHN MACHINERY COMPANY.

PRELIMINARY STATEMENT.

This controversy is between the United States of America and Ogilvie Hardware Company, Inc. A decision, however, by this Court on the question presented herein will vitally affect the rights of The Vaughn Machinery Company, which has filed an action against the United States of America in the Northern District of Ohio, Eastern Division, Civil Action File No. 23404, for a refund of income taxes (Surtax on Undistributed Profits) erroneously paid. That action involves the issue presented to this Court for determination in the instant case, viz., the effect of the issuance of a nontaxable stock dividend on the right of a corporation to a credit against surtax, under Section 26(c)(3) of the Revenue Act of 1936 as added by Section 501 of the Revenue Act of 1942.

In view of the fact that the decision of this Court might be determinative of the rights of The Vaughn Machinery

Company in its suit against the United States of America, The Vaughn Machinery Company has requested and secured the consent of petitioner's and respondent's counsel to file a brief amicus curiae in this action.

QUESTION PRESENTED.

Whether the phrase "deficit in accumulated earnings and profits," as used in Section 26(c)(3) of the 1936 Revenue Act, as amended,

(1) is to be accorded its common generic meaning, so as to refer to all earnings deficits

or

(2) is to be restricted so as to cover only certain earnings deficits, and so as to exclude that portion of such deficits arising from non-taxable stock dividends.

ARGUMENT.

IF A CORPORATION ISSUES A NONTAXABLE STOCK DIVIDEND AT A TIME WHEN IT HAS A SURPLUS, AND SUBSEQUENTLY A DEFICIT IS CREATED BY OPERATING LOSSES, THAT CORPORATION IS A "DEFICIT CORPORATION" WITHIN THE MEANING OF 26(c)(3) OF THE REVENUE ACT OF 1936 AS ADDED BY SECTION 501 OF THE REVENUE ACT OF 1942.

Section 14 of the Revenue Act of 1936 imposed a surtax on the net income of a corporation in an amount measured by the undistributed net income. Section 14 defined "undistributed net income" as meaning adjusted net income minus the credits provided by Sections 27 and 26(c). Section 26(c) allowed a credit for written contracts executed by a corporation prior to May 1, 1936, restricting the payment of dividends. This credit provision was strictly construed so as to preclude from its benefit deficit corporations which were prohibited by *state law* from paying dividends other than from surplus. In *Helvering v. Northwest Rolling Mills Company*, 311 U. S. 46, the Supreme Court held that

neither state laws of the character indicated, nor corporate charters, were a "written contract executed by the corporation prior to May 1, 1936" within the meaning of Section 26(c)(1) of the Revenue Act of 1936.

As a result of this decision, many corporations with impaired capital, prohibited by state law from paying dividends, were, nevertheless, subject to the Undistributed Profits Surtax on current earnings. Corporations and their directors were, therefore, placed in an anomalous position by the failure of Congress explicitly to grant a credit to corporations for earnings, the distribution of which was prohibited by state law. If a corporation declared improper dividends, both it and its directors would be liable under state law; if it failed to do so, it would be liable for a Surtax on Undistributed Profits under Section 14 of the 1936 Revenue Act.

It was for the express purpose of remedying this situation that Congress in 1942 enacted Section 501, which added subdivision (3) to Section 26(c) of the 1936 Revenue Act. Section 26(c)(3), as so amended, then allowed the following credit:

> "(3) Deficit Corporations.—In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936."

This brings us to a consideration of the significance of the phrase "deficit in accumulated earnings and profits." The Government takes the position that this phrase should be read: "*some kind* of deficits in accumulated earnings and profits." It superimposes a technical, restrictive gloss on the common meaning of the phrase: "deficit in accumulated earnings and profits;" by reducing

such earnings deficits by nontaxable stock dividends the petitioner, in effect, denies that the phrase means what it says. Petitioner would restrict it to *some* earnings deficits.

As opposed to the Government's refusal to apply this phrase as it reads, we have the following considerations:

(1) The phrase: "deficit in accumulated earnings and profits" is plain and unambiguous and may not be limited to deficits arising in a particular manner.

(2) Since the language of Section 501 of the Revenue Act of 1942 is clear and unambiguous, it requires no reference to extraneous aids for its construction.

(3) If extraneous aids are used and Section 501 is construed to carry out Congress' purpose, "deficit in accumulated earnings and profits" can not be limited to some kinds of earnings deficits.

(4) Section 115(h) of the 1936 Revenue Act has no application to the credit granted corporations by Section 501 of the Revenue Act of 1942.

(5) The phrase: "deficit in accumulated earnings and profits", when given its commonly accepted construction has independent significance.

Point (1). The phrase: "deficit in accumulated earnings and profits" is plain and unambiguous and may not be limited to deficits arising in a particular manner.

The term "deficit in accumulated earnings and profits" has a well-understood meaning. It relates to a corporation whose earned surplus has been depleted to such an extent that its capital is impaired. It is immaterial under state laws prohibiting the payment of dividends out of capital that the corporation's deficit has been caused in a particular manner or is the result of certain transactions. The important factor is that the corporation no longer has earnings and profits *available for distribution under state laws.*

The fact that a portion of a corporation's deficit is the result of a nontaxable stock dividend issued at a time when the corporation did have accumulated earnings and profits available for distribution does not render a corporation any less amenable to state laws prohibiting dividend payments to corporations with earnings deficits.

There is nothing in the language of Section 501 of the 1942 Revenue Act to suggest even faintly that Congress intended to limit the words "deficit in accumulated earnings and profits" to only *certain kinds* of earnings deficits. If Congress had intended to limit the credit to those corporations whose deficits had been caused in a particular manner, it would have been a simple matter for it to do so. Congress having failed to restrict expressly the operation of the credit, the Government cannot now claim that the meaning of the words "deficit in accumulated earnings and profits" is one other than its plain and obvious one and is limited to *some types* of such deficits.

Stripped down to its essentials, the petitioner's argument necessarily comes down to this: "A corporation has a deficit. The deficit was caused in a certain way. Therefore, the corporation has no deficit." *That a deficit was caused in a certain manner, however, does not contradict the existence of the deficit.*

The Fifth Circuit Court of Appeals, in affirming the judgment of the District Court in the instant case, specifically considered the meaning to be attached to the words "deficit in accumulated earnings and profits" as used in Section 501 and reached the following conclusion (155 F. (2d) 577, 579):

> "*Turning to the words in the federal amendment, 'a deficit in accumulated earnings and profits,' they are not specially defined and ought to have their natural, common meaning.* They occur twice in the single clause of the amendment. In the second occurrence the context is, 'the corporation is prohibited by law from paying dividends during the existence of a

deficit in accumulated earnings and profits.' *Clearly the deficit here referred to is that which the state law makes a deficit in prohibiting the payment of dividends.* We see no propriety in construing a different meaning in their first occurrence. 'In the case of a corporation having a deficit in accumulated earnings and profits.' It is the same corporation in the same condition that is referred to. * * * *There is no justification for saying that in the last quoted phrase the deficit meant is that which may be figured by adding all the earnings and profits the corporation has made since its beginning and subtracting only what has been paid out in taxable dividends.*" (Emphasis supplied.)

Point (2). Since the language of Section 501 of the Revenue Act of 1942 is clear and unambiguous, it requires no reference to extraneous aids for its construction.

It is well understood that resort will not be had to extraneous aids to legislative construction (e.g., Congressional committee reports, Commissioner's Regulations, etc.) where they purport to construe provisions of an act which are free from ambiguity and doubt. Such a principle would apply in the instant controversy in view of the clear and unambiguous language employed by Congress.

In *Koshland v. Helvering*, 298 U. S. 441, 446-47, the Supreme Court clearly enunciated the rule in these words:

> "Where the Act uses ambiguous terms or is of doubtful construction, a clarifying regulation, or one indicating the method of its application to specific cases, not only is permissible but is to be given great weight by the courts. And the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement. *But where, as in this case, the provisions of the Act are unambiguous, and its direction specific there is no power to amend it by regulations.*" (Emphasis supplied.)

In *United States v. Mo. Pac. R. Co.*, 278 U. S. 269, 278, the following statement as to the use of extrinsic aids when the language of a statute is clear and unambiguous is particularly apposite:

> "Where doubt exists and construction is permissible, reports of the committees of Congress and statements by those in charge of the measure and other like extraneous matter may be taken into consideration to aid in the ascertainment of the true legislative intent. But *where the language of an enactment is clear and construction according to its terms does not lead to absurd or impracticable consequences, the words employed are to be taken as the final expression of the meaning intended.* And in such cases legislative history may not be used to support a construction that adds to or takes from the significance of the words employed." (Emphasis supplied.)

Not only is the phrase: "deficit in accumulated earnings and profits" clear, but "construction according to its terms does not lead to absurd or impracticable consequences." On the other hand, *the petitioner's restrictive gloss would "lead to absurd or impracticable consequences."* Suppose a corporation with $100,000 capital and $150,000 earned surplus declared a stock dividend in 1912, with resulting $200,000 of capital and $50,000 of surplus. On December 31, 1936, its surplus is nonexistent and its capital is impaired by $10,000. In 1937 its net income is $9,000. The petitioner would not permit a credit for the amount of the December 31, 1936 "deficit in accumulated earnings and profits." Petitioner would have the corporation pay a Surtax on Undistributed Profits even though it winds up the year with impaired capital and with a "deficit in accumulated earnings" by any reasonable construction of the phrase.

Point (3). If extraneous aids are used and Section 501 is construed to carry out Congress' purpose, "deficit in accumulated earnings and profits" can not be limited to some kinds of earnings deficits.

Assuming *arguendo* that the Congressional Committee Reports can be taken into consideration to assist in ascertaining the meaning of the amendment herein involved, an examination of the Senate Finance Committee Report on the 1942 Revenue Bill does not reveal any information that supports the Government's position; on the contrary, it lends further support to our interpretation of the application of the amendment. The pertinent parts of that Report are the following (Senate Report No. 1631, 77th Cong., 2d Sess., 245-46):

> "Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax at various rates from 7 to 27 percent of their undistributed net income. *In some instances State law or an order of a public regulatory body prohibited payment of dividends during the existence of a deficit even though the corporation had current earnings and profits which would constitute undistributed net income under the definition thereof in section 14(a)(2).* Such corporations were, therefore, subject to undistributed profits surtax even though they were prohibited by law from paying dividends. The addition of the new paragraph 3 to subsection (c) of section 26 to provide an additional credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year is intended to give relief in certain of these cases." (Emphasis supplied.)

The Report clearly states that Section 501 is intended to give relief to those corporations which were prohibited by state law from paying dividends during the existence of a deficit in accumulated earnings and profits. *It makes no reference to limiting "deficit in accumulated earnings and*

profits" to one caused solely by operating losses or by the issuance of a taxable dividend.

We can, therefore, conclude that in view of the unambiguous language employed in Section 501 and in view of Congress' purpose in granting this relief, the words "deficit in accumulated earnings and profits," require a construction which gives effect to their plain and ordinary meaning. That is, the benefit of Section 501 is intended to cover those corporations prohibited by state law from paying a dividend during the existence of a deficit in accumulated earnings and profits regardless of the *cause* of that deficit.

Point. (4). Section 115(h) of the 1936 Revenue Act has no application to the credit granted corporations by Section 501 of the 1942 Act.

The Government contends that Section 115(h) of the Revenue Act of 1936 supports its position that a deficit in earnings and profits must be reduced by nontaxable stock dividends in arriving at the credit for such deficit under Section 26(c)(3). Section 115 reads in part as follows:

"Sec. 115. DISTRIBUTIONS BY CORPORATIONS.

"(h) *Effect on Earnings and Profits of Distributions of Stock.*—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or (2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act."

As can readily be observed from the foregoing, Section 115(h) deals exclusively with the tax liability of *stockholders*; it has no relation to a *corporation's* liability for taxes. A reading of *all* of Section 115 indicates that it is concerned exclusively with the characterization of corporate distributions to *stockholders*: whether the distributions are taxable and, if so, whether the income is ordinary or capital. Subdivision (h), a part of Section 115, limits the usual meaning of "earnings or profits" *as used in Section 115(a), (b), and (g), in determining whether corporate distributions constitute ordinary dividends in the hands of stockholders.*

In *United States v. Byron Sash & Door Co.*, 150 F. (2d) 44, the precise issue now before this Court was presented, and the Sixth Circuit Court of Appeals came to the same conclusion as did the Fifth Circuit Court of Appeals in the instant case, that is, the conclusion advocated by amicus curiae. In discussing the effect of Section 115(h), the Sixth Circuit Court of Appeals declared (at page 46):

> "Section 115(h) deals with the taxable status of the *stockholder* who receives the stock dividends, rather than with the liability of the *corporation* for tax, and to use this provision of the statute in order to ignore the deficit in the case before us, and to deny credit on undistributed profits surtax to this corporation seems untenable." (Emphasis supplied.)

A like construction as to the inapplicability of this Section to the credit provided in Section 501 of the 1942 Revenue Act was expressed by the Circuit Court of Appeals below in the instant case (155 F. (2d) 577, 580):

> "This section has reference not to the taxes or credits of the corporation, but only to the taxation of a shareholder as a reading of the whole section will show. * * * We do not think this provision has any bearing on the 1942 amendment under discussion, which relates to the taxation of the corporation itself for not distributing its current income."

Even more recently, in *Philadelphia Carpet Co. v. United States*, 68 Fed. Supp. 712 (D. C. E. D. Pa. 1946) the Court followed the *Byron Sash & Door* and the *Ogilvie Hardware Co.* cases for the reasons therein expressed by the Sixth and Fifth Circuit Courts of Appeals.

The only case in which an issue somewhat similar to the one before this Court has been decided in favor of the Government is *Century Electric Company v. Commissioner*, 144 F. (2d) 983 (CCA 8th, 1944). It is difficult to determine from the opinion in that case the exact facts involved. The opinion, however, indicates that the stock dividend was distributed in the taxable years there at issue and does suggest that a capital deficit remained immediately following the stock dividend, and that, therefore, the dividend was the *direct* cause of the deficit. If this were the state of facts in the *Century Electric* case, then it is clearly distinguishable from the facts involved in the present controversy, as the Court in the *Byron Sash* case, *supra*, at page 46, clearly points out:

> "In other words, the Court (in the *Century* case) held that where a corporation had a surplus, a deficit within the meaning of the statute under which a credit is allowed, could not be effected by the distribution of a non-taxable stock dividend. In the *Century Electric* case, there was, therefore, no deficit but rather a surplus as of the close of each of the two taxable years preceding the distribution of the dividends, and, accordingly, no credit was allowed by the provisions of the statute. See also the report of the same case, *Century Electric Co. v. Commissioner*, in 3 T. C. 297. *The obvious difference between the Century case and the one before us is that in the former the claimed deficit was effected by the distribution of the stock dividends, while in the instant case, it was effected by the preceding seven years of operating losses.*" (Emphasis supplied.)

While, therefore, this Court might distinguish between the effect of a stock dividend leaving a surplus which is

subsequently wiped out by operating losses, and a stock dividend which itself wipes out a surplus, the clear language of Section 26(c)(3), as well as Congress' purpose in enacting it, permits of no limitation on "deficit in accumulated earnings and profits" in either situation. The precise facts of the instant case, however, do not require so broad a finding.

We have already indicated that in view of the unambiguous language of Section 501 extrinsic matter such as Committee Reports cannot properly be employed to support a construction not otherwise indicated by the words used. The Committee Reports on the 1942 Revenue Bill, however, further emphasize the inapplicability of Section 115(h) of the 1936 Act to the 1942 amendment which added Section 26(c)(3) to the 1936 Act. We will refer here once again to the Report of the Senate Finance Committee on the 1942 Revenue Bill, this time in particular to its reference to Section 115 of the 1936 Revenue Act. *That reference to Section 115 is completely unrelated to the 1942 Act's addition of Section 26(c)(3) to the 1936 Act*; as will be seen, the sole reference to Section 115 was in connection with a completely different amendment.

The only reference to Section 115 in the Senate Finance Committee Report appears in Senate Report No. 1631, page 245. It reads as follows (quoted here at length—although it has no bearing at all on the instant question—only because the Government has relied on this Report and only in order to demonstrate that Section 115(h) was never intended to limit "deficit in accumulated earnings and profits" to *certain* kinds of such deficits):

> "Also under section 14 of the Revenue Act of 1936, it was possible that the undistributed net income of a corporation might exceed accumulated and current earnings and profits. In such case the tax could not be avoided even if distributions were made to shareholders. This result was primarily due to the fact that section 117(d) of the Revenue Act of 1936 limited

capital losses to $2,000 and section 27(a) and (b)* operated to disallow any credit where a distribution did not constitute a taxable dividend. Section 115 of the act provided that the term 'dividend' means a distribution from earnings or profits, either those accumulated after February 28, 1913, or those realized during the current taxable year. The purpose of the undistributed profits tax was to force the payment of taxable dividends. Where a corporation has no earnings or profits, it cannot make a taxable distribution which would constitute a dividend allowable as a dividends-paid credit in computing the undistributed net income subject to the surtax."

The foregoing explanation was devoted to the following difficulty under the unamended 1936 Act: A corporation could find itself in the position where its adjusted net income subject to the Undistributed Profits Surtax could not be reduced by a dividends paid credit—this because a "dividend" could be counted as such under Section 115(a) (and therefore as a credit against "adjusted net income") only to the extent of a corporation's accumulated or current year's "earnings or profits"; in certain situations "earnings or profits" were a smaller figure than "adjusted net income," as, for example, when a corporation had capital losses deductible in arriving at the former but not in computing the latter; in such a case, the dividends paid credit—because of the provision of Section 115(a)—could not equal the adjusted net income.

The allusion to Section 115 in the Senate Finance Committee Report quoted above is in connection with the amendment which augmented the credit by the excess of adjusted net income over the possible dividend paid credit. We quote that amendment by Section 501 of the 1942 Act, adding to the 1936 Act Section 26(f) (but, again, only to demonstrate that the amendment, together with the Committee's reference to Section 115, has absolutely no bear-

* This is obviously an error and should read "(h)."

ing on the other amendment in which we are interested in this case, and which added Section 26(c)(3)):

> "(f) Deficit Credit.—The amount by which the adjusted net income exceeds the sum of (1) the earnings and profits accumulated after February 28, 1913, as of the beginning of the taxable year, and (2) the earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year) * * *."

It is only in connection with the foregoing amendment that Senate Report No. 1631 mentions Section 115 of the 1936 Act and then only to define the word "dividend." It is apparent, therefore, that this reference to Section 115 is limited to this particular amendment adding subsection (f) to Section 26 of the 1936 Act. It was not intended to apply to that amendment adding Section 26(c)(3) which granted a credit to deficit corporations prohibited by state law from paying dividends during the existence of a deficit.

This analysis is substantiated by a reading of the House Ways and Means Committee Report on the 1942 Revenue Bill (House Report No. 2333, 77th Cong., 2nd Sess., page 170), which is substantially the same as the Senate Report, quoted above.

Section 501 of the 1942 Act, as *originally* passed by the *House*, did *not* contain the provision that a corporation with a deficit in accumulated earnings and profits was entitled to a credit against surtax if it were prohibited by state law from paying dividends during the existence of such a deficit; that is, it did not add subdivision (3) to Section 26(c) of the 1936 Act. The House 1942 Bill did, however, contain the amendment adding Section 26(f). It follows even more clearly, therefore, that the Ways and Means Committee Report reference to Section 115 had nothing whatever to do with the later amendment *by the Senate* which added subdivision (3) to Section 26(c). The Senate Bill not only added Section 26(f), as did the

House Bill, but also added subdivision (3) to Section 26(c), granting relief to corporations prohibited by state law from paying dividends. The Senate Report, in referring to Section 115 of the 1936 Act, adopted the language of the House Report. We can, therefore, conclude that the Senate Committee intended to confine its discussion of Section 115 to the very thing to which the House Report did, namely, Section 26(f). It would be absurd to claim that this discussion has reference to subdivision (3) of Section 26(c), when that provision never even appeared in the House Bill.

It will be seen, therefore, that the reference to Section 115 in the House and Senate Reports does not relate at all to the amendment adding subdivision (3) to Section 26(c), and this is borne out both by the wording itself of those Reports, as well as by the legislative progress of Section 501 of the 1942 Revenue Bill.

Point (5). The Phrase: "deficit in accumulated earnings and profits" when given its commonly accepted construction has independent significance.

The Government might take the position that a common-sense interpretation of the phrase: "deficit in accumulated earnings and profits" reduces it to insignificance because—so might run the Government's argument—Section 26(c)(3) would then give relief in all cases when local law prevents corporate distributions. That is not the case. The phrase has vitality even when given its ordinary meaning for at least two reasons.

In the first place, the phrase, "deficit in accumulated earnings and profits," operates independently as a *measure* of the *credit* afforded by Section 26. The pattern of the 1936 Act's treatment of the Surtax on the Undistributed Profits clearly explains the phrase's significance, without benefit of any artful, technical, restrictive gloss. Section 14 imposes a tax measured by "undistributed net income."

"Undistributed net income" is computed after adjustment for "the credit provided in Section 26(c)," or, in simpler words, after certain subtractions. Subsections (1) and (2) of Section 26(c) as originally enacted started off, naturally enough, with subtractions for: "An amount equal to * * *" etc., etc. Similarly, subdivision (3) allows a subtraction: "In the case of a corporation having a deficit in accumulated earnings" of "the amount of such deficit" providing local law prohibits the distribution.

Take Example (1) of Article 26-2 of the Commissioner's own Regulations 94:

> "The M Corporation for the calendar year 1936 had an adjusted net income of $200,000 but had an actual deficit in accumulated earnings and profits as of December 31, 1935, of $20,000. By reason of a State law in effect prior to May 1, 1936, with respect to deficit corporations, the M Corporation was prohibited from paying dividends during the existence of such deficit. Under section 26(c)(3), the M Corporation is allowed a credit of $20,000."

So the reference to earnings deficits *measures* the credit—and this quite apart from the requirement of a local law prohibition; indeed, the "deficit" language of Section 26(c)(3) operates so that some corporations prohibited by state law from paying dividends, derive a *credit less than their adjusted net incomes*—as witness the very example above.

In the second place, the local prohibition requirement relates broadly to dividends being precluded by "a law or * * * an order of a public regulatory body." Such a broad prohibition, standing alone, would sometimes operate even when there were no capital impairment in the usual, conventional sense. The requirement that there be a deficit in earnings operates independently to deny relief, therefore, in many specialized situations, as for example, where public utilities commissions prohibit dividend payments in certain particular situations; public regulatory

bodies often prohibit dividend payments although there is no deficit in earnings in the conventional sense. Our construction of "deficit in accumulated earnings" therefore gives the phrase independent meaning.

In light of the foregoing, we respectfully submit that the decisions of the Fifth and Sixth Circuit Courts of Appeals give to the phrase: "deficit in accumulated earnings and profits," its common, everyday, generic meaning, and that those decisions carry out the intention of Congress to afford relief from the penalty Surtax on Undistributed Profits.

CONCLUSION.

The judgment appealed from is correct and should be affirmed.

Respectfully submitted,

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NO. 430

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

UNITED STATES OF AMERICA, *Petitioner,*

v.

OGILVIE HARDWARE COMPANY, INC.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

BRIEF AMICUS CURIAE.

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Statement of Managers on the Part of the House, in House Conference Report No. 2586, Oct. 19, 1942 on H. R. 7378, 77th Cong. 2nd Sess., pp. 71-72 11-12
Statement of William A. Sutherland before Senate Finance Comm. Hearing, 77th Cong. 2nd Sess., vol. 2, pp. 1421-1422 5-6
Senate Finance Comm. Report No. 1631 on section 501 of the Revenue Act of 1942 (H. R. 7378), 77th Cong. 2nd Sess. 2, 7-8, 11

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 430.

UNITED STATES OF AMERICA, *Petitioner*,

v.

OGILVIE HARDWARE COMPANY, INC.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

BRIEF AS AMICUS CURIAE BY HAWAIIAN CANNERIES COMPANY, LTD., HONOLULU, HAWAII.

PRELIMINARY STATEMENT.

The Hawaiian Canneries Company, Ltd., Honolulu, Hawaii, asks that this brief be considered by the Court in support of the opinion and judgment of the United States Circuit Court of Appeals for the Fifth Circuit in the above entitled cause. Counsel for the petitioner and for the respondent herein have consented to the filing of this brief.

The Hawaiian Canneries Company, Ltd., has a suit pending in the Court of Claims of the United States, No. 47332,

Hawaiian Canneries Company, Ltd., Plaintiff v. *The United States of America, Defendant*, and the facts therein are substantially the same and the questions of law are identical with those in the case at bar.

QUESTION INVOLVED.

Whether the tax relief credit for state or territorial statutorily prohibited dividends granted by Congress to deficit corporations by section 26(c)(3) of the Revenue Act of 1936, as amended by section 501 of the Revenue Act of 1942, is cut down and limited by illustrated example No. 2 used in the report No. 1631 of the Committee on Finance, United States Senate, 77th Congress, Second Session.

ARGUMENT.

I.

The legislative history of Section 501 of the Revenue Act of 1942 discloses that Congress amended Section 26 (c) (3) of the Revenue Act of 1936 in order to grant deficit corporations a credit for state or territorial statutorily prohibited dividends, and to remove the hardships resulting from imposition of the undistributed profits surtax due to failure to allow credit for such dividends under the law prior to amendment.

Section 501 of the Revenue Act of 1942 was enacted by Congress to overcome the hardship on deficit corporations resulting from the decisions of the Board of Tax Appeals, affirmed November 12, 1940 by the Supreme Court of the United States, in the cases of *Helvering* v. *Northwest Steel Rolling Mills*, 311 U.S. 46, 85 L. ed. 29, and *Crane-Johnson Co.* v. *Helvering*, 38 B.T.A. 1355, 311 U.S. 54, 85 L. ed. 35, that section 26(c)(1) of the Revenue Act of 1936 "does not authorize a credit for statutorily prohibited dividends" where the "respondent corporation, because of a previously existing deficit, was prohibited by state law from distributing as dividends its profits earned in 1936". (*Hel-*

vering v. Northwest Steel Rolling Mills, 311 U.S. 46, 48, 49).

The Congressional Hearings and Committee reports on the "Revenue Act of 1942" disclose that Congress added the new paragraph (3) to section 26(c) of the Revenue Act of 1936 to remove the admitted hardship on deficit corporations from the imposition of the undistributed profits tax where such corporations were prohibited by a state or local law from distributing dividends during the existence of a deficit.

Section 501 of the Revenue Act of 1942 clearly shows that the corporation's deficit under section 26(c)(3) of the Revenue Act of 1936, as amended, was determined by the state or territorial law, and not by section 115(h) of the Revenue Act of 1936, which last section provides that a stock dividend shall not be considered a distribution of earnings or profits of any corporation to a distributee. Section 115(h) is merely a codification of the law since *Eisner* v. *Macomber*, 252 U.S. 189. Congress never intended that section 115(h) was to be used to cut down the relief, for deficit corporations from hardship of the undistributed profits tax under section 26(c)(3), as amended.[1]

During the consideration of the Revenue Act of 1942 Congress took up the question of "hardships and inequities" arising out of the revenue acts. (Hearings, House Ways & Means Committee, 77th Congress, Second Session, Revenue Revision of 1942, pp. 87-94). Although the un-

[1] *Cf.* The decision of the Tax Court of the United States in *Arrow-Hart Hegeman Electric Co.* v. *Commissioner*, 7 T. C. No. 158, pp. 10, 11 (promulgated December 19, 1946, and Reviewed by the Court) wherein it was held that subsections (a) and (b) of section 115 of the Revenue Act of 1936 (which provisions limited relief from surtaxes to "the amount of earnings accumulated at the time a dividend was declared and paid and to the extent of the current year's earnings which were distributed") could not be used by the Commissioner to cut down relief granted to taxpayers by Congress (second Revenue Act of 1940, as amended by the *Revenue* Act of 1942) under Section 721 of the Internal Revenue Code from excess profits tax in abnormal cases.

distributed profits tax, imposed by the Revenue Act of 1936, had been repealed by the Revenue Act of 1939, Congress considered under section 501 of the Revenue Act of 1942 a retroactive credit to deficit corporations for statutorily prohibited dividends.

At the conclusion of the hearing on the Revenue Revision of 1942, the House Ways and Means Committee on July 14, 1942, reported out House Bill H.R. 7378, but section 501 thereof did not contain any relief provision to deficit corporations for statutorily prohibited dividends.

Later, during the hearing before the Senate Committee on Finance, 77th Congress, Second Session, on H. R. 7378, a number of taxpayers filed briefs and urged Congress to amend section 501 of the Revenue Act of 1942 to permit retroactive relief from the undistributed profits tax where a state or local law prohibited the payment of dividends. Among those protesting the limited relief granted by section 501 of the House bill was the Paris and Mount Pleasant Railroad of Texas. This Texas railroad company directed the attention of the Senate Finance Committee to a decision (which had just been handed down by the Board of Tax Appeals), in the case of *Paris & Mt. Pleasant Railroad Co.* v. *Commissioner*, 47 B.T.A. 443, which held:

> "• • • there is nothing in this case to take it out of the rule of *Crane Johnson Co.*, 38 B.T.A. 1355; affd., 311 U.S. 54; and *Helvering* v. *Northwest Steel Rolling Mills, Inc.*, 311 U.S. 46. In both cases the corporations had existing deficits and they were prohibited by state statutes from paying dividends except out of surplus. Section 26(c)(1) allows a credit if dividends can not be distributed without violating the terms of a written *contract* executed prior to May 1, 1936, which expressly deals with the payment of dividends. 'The language used in section 26(c)(1) does not authorize a credit for *statutorily* prohibited dividends.' (Italics added.) *Northwest Steel Rolling Mills, Inc., supra.*"

The protest of this Texas Railroad Company concluded with "the hope that Congress will extend the benefits of

section 501 of the pending revenue bill to taxpayers circumstanced as was the Paris and Mt. Pleasant Railroad Co. in 1937". (Senate Finance Comm. Hearings, Vol. 2, pp. 2343-2345.)

Mr. William A. Sutherland, of Sutherland, Tuttle & Brennan, Atlanta, Georgia, also testified before the Senate Finance Committee on August 10, 1942, and asked Congress to include in section 501 a general relief provision for deficit corporations where a state law prohibited the payment of dividends during the time the corporation had a deficit. He testified on this matter as follows:

> "Now, I would not say, as a matter of policy, whether I think it is wise at this time to go back and attempt to relieve against the unreasonable hardships under prior acts. I don't know whether I would ever have thought of recommending that that be done at a time like this.
>
> If, however, the Senate is going back and relieve against one of the obvious hardships under the 1936 act, I certainly think there is another case that is equally entitled to be covered.
>
> What you have done by section 501 is to relieve a corporation from undistributed-profits-tax, when it was in such position that if it had paid out money as a dividend, the distribution would not have been taxable as a dividend, and therefore there would be no dividend paid credit, and the corporation would not be relieved of the undistributed-profits tax.
>
> The original 1936 act relieved from the undistributed profits tax corporations which were forbidden by contracts made prior to May 1, 1936, to pay out money as dividends.
>
> The other obvious injustice which I think should be corrected is this: You did nothing in the original act, and have done nothing here, about those corporations which are prohibited by State law, because they have a deficit, from paying out dividends, and I see no reason in the world why if these two cases—the one that you covered in the 1936 act and the one that you are now covering here by section 501—are going to be covered you should not relieve from the undistributed-

profits tax, in those situations where State law forbids the payment of a dividend.

In Georgia, if a dividend is paid when there is a deficit in the corporation, the directors are liable for double damages to anyone who is harmed.

I understand that the Treasury opposes that provision and says that, if you are going to relieve in such a situation, there are some other situations that are equally entitled to relief.

If that is true, I say they ought to be covered, if you are going into the question at all. The fact that there are other situations is no reason for not relieving this situation, which, it seems to me, is just as obvious as the one covered by section 501."

(Hearings, Senate Finance Comm., 77th Cong., 2nd Sess., on H.R. 7378, vol. 2, pp. 1421-1422).

At the conclusion of the Senate hearing, Senator George of Georgia, Chairman of the Senate Finance Committee, on October 2, 1942 reported out H.R. 7378 with the following Senate amendments to section 501.

It amended section 14(a)(2) of the Revenue Act of 1936 (relating to definition of undistributed net income) by striking out in the House bill (H.R. 7378), " * * * the credit provided in section 26(c), *relating to contracts restricting dividends,* * * * ", and inserting in place thereof, " * * * the credit provided in section 26(c) *relating to restrictions on payment of dividends,* * * * ". The Senate also added the following new paragraph 3 to section 26(c):

"(2) Section 26(c) of the Revenue Act of 1936 (relating to credits of corporations) is amended by amending the heading to read as follows: "(c) RESTRICTIONS ON PAYMENT OF DIVIDENDS.—"; and by amending paragraph (3) to read as follows:

"(3) DEFICIT CORPORATIONS.—In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends dur-

ing the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936."

It should be noted that the language of section 26(c)(3), as amended, follows the amendment requested at the Senate Finance Committee hearing.

There is no ambiguity about section 26(c)(3). It means exactly what it says, namely that a credit will be granted to a deficit corporation if there is (1) an existing deficit as of the close of the preceding taxable year recognized by the state law, and (2) if there is a state law in existence prior to May 1, 1936 prohibiting the deficit corporation from paying dividends during the existence of such deficit.

The meaning of the statute is clear, and there is no need to refer to the reports of the Congressional Committees to obtain a proper construction of section 26(c)(3). However, the Committee reports show that Congress intended that the State law should be the guide in determining if the corporation had a deficit in accumulated earnings and profits as of the close of the preceding taxable year. The Committee reports show that Congress was removing the restrictions as held by the Board of Tax Appeals in the *Crane Johnson case*, 38 B.T.A. 1355, 1358, that, "The underlying plan of this surtax is to allow credit only for actual distributions," and to substitute in place thereof *a credit for state statutorily restricted distributions.* The Senate Finance Committee Report No. 1631 on section 501 states (pp. 244-245):

> "This section is the same as in the House bill, except that a new paragraph to section 26(c) has been added, providing for an additional credit in cases of corporations having a deficit in accumulated earnings and profits and prohibited by law from paying dividends, • • •
>
> Section 501 amends section 14(a)(2) of the Revenue Act of 1936 relating to definition of undistributed net income, and section 26 of that act, relating to credits of corporations, and grants relief from the undistrib-

uted-profits tax for taxable years beginning after December 31, 1935, and prior to January 1, 1938, by allowing as an additional credit in computing undistributed net income the portion of the adjusted net income which, in certain instances, could not be distributed as taxable dividend."

* * * * * * * * * *

"Under section 14 of the Revenue Act of 1936 corporations in general were subject to surtax at various rates from 7 to 27 percent of their undistributed net income. *In some instances State law or an order of a public regulatory body prohibited payment of dividends during the existence of a deficit even though the corporation had current earnings and profits which would constitute undistributed net income under the definition thereof in section 14(a)(2). Such corporations were, therefore, subject to undistributed-profits surtax even though they were prohibited by law from paying dividends.* The addition of the new paragraph 3 to subsection (c) of section 26 to provide an additional credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year is intended to give relief in certain of these cases." (Italics supplied).

The "certain cases" referred to in the last sentence of the Senate report are those deficit corporation cases where there was a state or territorial law prohibiting the payment of dividends during the existence of a deficit in accumulated earnings and profits as such deficit was defined by the state or territorial law.

There is nothing in the wording of section 501 which denies the full credit to "*a corporation*" which prior to the tax year 1936 had declared a non-taxable stock dividend out of a portion of its accumulated earnings and profits. Under the state law of Louisiana (and the laws of many other states and territories of the United States) a stock dividend changes accumulated earnings and profits into capital. The stock dividend capital is merged with the capital which the corporation (previously or later) acquires by the sale of its

stock, and the payment of a dividend under such circumstances is prohibited by the state or local law just as effectually as if the deficit was otherwise created.

II.

The illustrated example No. 2 in Senate Finance Committee's Report No. 1631 on Section 501 relates only to a tax-free-reorganized corporation case. It does not limit the credit under Section 26 (c) (3), as amended, to a corporation which is not a tax-free-reorganized corporation if that corporation prior to May 1, 1936, has declared stock dividends.

In discussing the application of the deficit credits, it is apparent that the author of illustrated example No. 2 in the Senate Finance Comm. Report No. 1631, p. 246, believed that the credit provided by section 26 (c) (3) did not cover the liabilities of an older corporation which had been assumed by "the X Corporation" under a tax-free reorganization. He apparently assumed that the credit for a deficit corporation under section 26 (c) (3) did not apply to the debts of the older corporation because the Supreme Court in the case of *New Colonial Ice Company* v. *Helvering*, 292 U. S. 435, 78 L. ed. 1348, held that a reorganized corporation is not entitled in determining its taxable income for the succeeding period, to deduct a net loss sustained by the older corporation in the preceding period, under the provisions of section 204 (b) of the Revenue Act of 1921 permitting the deduction of a net loss sustained by any taxpayer from the net income of the taxpayer for the succeeding taxable year.

The author of illustrated example No. 2 also must have had in mind the holdings of this Court that a distinction exists between the type of stock dividend declared by "a corporation" and a stock dividend arising out of a nontaxable reorganization corporation case. See, *United States* v. *Phellis*, 257 U. S. 156, 66 L. ed. 180; *Cullinan* v. *Walker*, 262 U. S. 134, 67 L. ed. 906, and other cases cited in *Helvering* v. *Griffiths*, 318 U. S. 371, 87 L. ed. 843. The distinction

was made in illustrated example No. 2 because a stock dividend declared and distributed under a nontaxable reorganization plan is a dividend of profits of the corporations and is individual income to the stockholders and taxable as such. *Rockefeller* v. *United States*, 257 U. S. 176, 66 L. ed. 186; whereas the stock dividend declared by the *Ogilvie Hardware Company, Inc.*, is the type of stock dividend declared in *Eisner* v. *Macomber, supra*, and it is not income and is not taxable; it is a conversion of accumulated earnings and profits into capital of the corporation.

That the illustrated example No. 2 in the Senate Finance Committee's report No. 1631 referred only to a tax-free-reorganized-corporation is also apparent from the fact that the Senate Finance Committee's attention was directed to a tax-free-reorganized-corporation case then pending before the Board of Tax Appeals. In that case a credit was claimed under section 26(c)(2)—(contracts restricting payment of dividends) for "amount of debt reductions made out of income from properties constituted contract credits." In this reorganized-corporation case the Treasury had followed the decision in the *New Colonial Ice Company case, supra*, and ruled that since the statute dealing with the undistributed profits tax used "the terminology 'the corporation,' the resulting credit would be denied." (Hearings, Senate Finance Comm. Vol. 1, pp. 1306-1308.)

The above illustrated example No. 2 in the Senate Finance Committee report does not apply to the *Ogilvie Hardware Company* case because it is not a tax-free-reorganized corporation. It does not seek a credit under section 26 (c) (3) for any older corporation, and no part of its deficit is due to "a prior capitalization of surplus in the course of a nontaxable reorganization". In the case at bar there is only one corporation which was prevented by a state law from distributing dividends while it had a deficit in accumulated earnings and profits.

The general rule that the statutory provision is not to be limited to the illustrations used in the committee reports

is stated in Mertens', Law of Federal Income Taxation, Vol. 1, sec. 3.29, pp. 116-117:

> "The Finance Committee of the Senate and the Ways and Means Committee of the House have made a practice of explaining in formal reports the purpose of specific provisions of the revenue statutes. These reports are helpful in determining legislative intent. They do not, of course, take the place of the statute, *and the statutory provision is not to be limited to the illustrations used in the committee reports unless it is clearly evident that the illustration was used for that purpose.*" (Italics supplied.)

The petitioner at page 20 of his brief frankly admits that illustrated example No. 2 in the Senate Finance Committee's report refers only to a case of a corporation resulting from a tax-free reorganization. In view of this admission and because it is not clearly shown that Congress intended the illustrated example No. 2 to cut down relief under section 26 (c) (3) to a deficit corporation, which had declared stock dividends prior to May 1, 1936, the Court should hold that this illustration has no application to the case at bar.

The House of Representatives also did not adopt or approve the above discussed Senate Finance Committee illustrated example No. 2 when it accepted the Senate Amendment to section 501 of the Revenue Act of 1942. Its legislative action was directed to the bill, not to the Senate Finance Committee's report. It, therefore, appears that both the House and the Senate granted a credit under section 26 (c) (3) of the Revenue Act of 1936, as amended, to deficit corporations which were prohibited by state or territorial laws from distributing dividends during the existence of a deficit. This is further shown by the Statement of Managers on the Part of the House, in House Conference Report No. 2586, dated October 19, 1942, on H. R. 7378, which states (pp. 71-72):

> "Amendment No. 427 (Sec. 501): This amendment to the Revenue Act of 1936 provides an additional

credit for determining undistributed net income subject to undistributed profits surtax in certain cases of corporations having a deficit in accumulated earnings and profits and prohibited because of such deficit by a *State law* or order of a public regulatory body from distributing dividends. There is no comparable provision in the House bill. The amendment also expands the paragraph prohibiting double credits to contemplate the inclusion of this additional credit. * * * " (Italics supplied.)

III.

The Treasury Regulation is null and void because it conflicts with the statute.

We believe that the contentions of the petitioner at pages 30 to 32, inclusive, of his brief with respect to the unauthorized Treasury regulation are answered by the holdings of this Court in the case of *Manhattan General Equipment Co.* v. *Commissioner of Internal Revenue*, 297 U. S. 129, 134, 80 L. ed. 520, 531. The Court said in that case that a Treasury regulation which conflicts with the statute is void:

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity. *Lynch* v. *Tilden, Produce Co.* 265 U. S. 315, 320-322, 68 L. ed. 1034-1036, 44 S. Ct. 488; *Miller* v. *United States*, 294 U. S. 435, 439, 440, 79 L. ed. 977, 980, 981, 55 S. Ct. 440, and cases cited. And not only must a regulation, in order to be valid, be consistent with the statute, but it must be reasonable. *International R. Co.* v. *Davidson*, 257 U. S. 506, 514, 66 L. ed. 341, 346, 42 L. ed. 179."

See also the decision of the Tax Court in *Arrow-Hart & Hegeman Electric Company* v. *Commissioner*, 7 T. C. No. 158, p. 7, that an "Example" in the regulations of the Commissioner must carry out the Congressional intent.

The Court accordingly should affirm the opinion and judgment of the United States Circuit Court of Appeals for the Fifth Circuit in the case of *United States* v. *Ogilvie Hardware Company, Inc.*, 155 F. 2d. 577.

Respectfully submitted,

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Dated at Washington, D. C.
February 26, 1947.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

NO. 430

UNITED STATES OF AMERICA, *Petitioner*,

v.

OGILVIE HARDWARE COMPANY, INC.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

BRIEF AMICUS CURIAE.

JOHN E. HUGHES,
Amicus Curiae.

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UNITED STATES OF AMERICA, *Petitioner*,

v.

OGILVIE HARDWARE COMPANY, INC.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

BRIEF AMICUS CURIAE.

In *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 this court discovered and of its own motion announced that a course pursued by the federal courts for over a century and a half was unconstitutional.

In the case at bar it is submitted the court below has

clearly pointed out in the quotation from its opinion, contained at pages 22 and 23 of the government's brief herein, the manifest unconstitutionality of the course pursued by federal courts in recent years in giving administrative regulations the force of federal law and indeed sometimes in effect doing the same with committee reports. The ridiculous and illogical result of following this course has been thoroughly commented upon. See, Griswold, A Summary Of The Regulations Problems, 54 Harvard Law Review 398. Paul, 49 Yale Law Journal, 660. Surrey, 88 U. of Pennsylvania Law Review 556. See also 52 Harvard Law Review 1163 and 40 Columbia Law Review 252.

Because federal laws can only be made as expressly and *clearly* provided in the Constitution an administrative regulation or the opinion of one House of Congress or a committee thereof or even a message of the President saying he construes a bill (which he refused to veto) to mean thus and so, cannot be law and furthermore cannot aid either the legislative or executive to in effect usurp and limit the constitutional function of the courts to interpret statutes.

By Section 501 Of The Revenue Act Of 1942 It Was Intended To Give Relief To All Corporations Prohibited By State Law From Declaring Dividends.

This *amicus curiae* argued the case of *Crane Johnson Co.* v. *Helvering*, 311 U. S. 54 in this court and received letters from attorneys all over the country who had similar cases. When this court decided that case adversely, counsel in other cases were asked to help persuade Congress to set aside this court's decision and did so with vigor and will.

Amicus curiae appeared before the Senate Finance Committee and urged such action. See Senate Hearings On 1942 Revenue Bill at page 1022.

The treasury was opposed to this proposal and its legislative counsel tried to destroy the taxpayer's success by getting language inserted in the Committee report to which taxpayers and most committee members paid no attention.

After section 501 became law the Crane Johnson Company received a refund of the money it paid pursuant to this court's decision, with 6% interest.

The Revenue Code does not define the phrase "a deficit in accumulated earnings and profits and it is submitted the two capable and learned Circuit Courts of Appeal and the three District Courts which have decided the issue in taxpayer's favor were right in holding that in section 501 it clearly refers to such a deficit as brings into operation a state law prohibiting corporations declaring dividends. We know of no federal statutes which do so. If there exist such prohibitions they only exist in state law. Such laws prohibit earnings after being frozen and transmitted into capital by stock dividends being distributed as dividends.

It is clear taxpayer at bar had a deficit within the meaning of state law and it is submitted that if Congress gave relief to deficit corporations which could not distribute income because of state law it gave relief to *all* such deficit corporations and not to some. No reason appears for any such distinction as the government asks the court to make. As said in *Colgate v. United States*, 320 U. S. 422, 425 "a desire for equality among taxpayers is to be attributed to Congress rather than the reverse".

That the prohibition of State law is the crux of this Statute is obvious from the fact that without such prohibition even a corporation having a deficit within the meaning assigned this term by the government's brief could distribute dividends.

SUPREME COURT OF THE UNITED STATES

No. 430.—October Term, 1946.

The United States of America, Petitioner, v. Ogilvie Hardware Company, Inc.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[April 7, 1947.]

Mr. Justice Black delivered the opinion of the Court.

This is a suit for tax refund which the District Court allowed. 62 F. Supp. 338. The Circuit Court of Appeals affirmed. 155 F. 2d 577. We granted certiorari because of an apparent conflict with *Century Electric Co.* v. *Commissioner*, 144 F. 2d 983.

The respondent, Ogilvie Hardware Co., Inc., was incorporated in Louisiana in 1907 with a paid in capital of $100,000. In 1924 it increased its capitalization to $200,000 by declaration of a $100,000 stock dividend out of past earnings. Depressed business conditions during the 1930's brought heavy operating losses so that by 1937 the company's assets were about $71,000 less than the $200,000 capitalization. The company books accordingly showed a deficit in this amount. By 1938 this deficit was reduced to about $61,000. In this financial posture the corporation could not declare dividends without impairing its then capital structure (which included capitalization of the $100,000 stock dividend) and Louisiana law prohibited payment of a dividend under such circumstances.[1] Section 14 of the governing Rev-

[1] "I. No corporation shall pay dividends in cash or property, (a) except from the surplus of the aggregate of its assets over the aggregate of its liabilities, plus the amount of its capital stock; or (b) out of any surplus due or arising from—(1) any profit on treasury shares before resale; or (2) any unrealized appreciation in value or revaluation of

enue Act of 1936 imposed a surtax on certain corporate net income earned during the tax year but not distributed as dividends.[2] It provided no exemption from that surtax because a corporation had an accumulated deficit at the beginning of the tax year, or because state law prohibited payments of dividends.

Acting under this 1936 law, the Commissioner, on examination of respondent's 1937 and 1938 tax returns, determined that respondent was subject to the undistributed profits tax, despite the deficit and the state prohibition against payment of dividends. The Commissioner's interpretation and application of the 1936 Act was in accord with our holding in *Helvering* v. *Northwest Steel Rolling Mills*, 311 U. S. 46, and *Crane-Johnson Co.* v. *Helvering*, 311 U. S. 54. The taxpayers in those cases claimed exemption from the surtax on the ground that they could not distribute dividends "without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision deals with the payment of dividends." Section 26 (c) (1) of the 1936 Act relieved corporations from the tax if such contracts existed. 49

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fixed assets; or (3) any unrealized appreciation in value or revaluation of inventories before sale; or (4) the unaccrued portion of unrealized profit on notes, bonds or obligations for the payment of money, purchased or otherwise acquired, unless such notes, bonds or obligations are readily marketable, in which case they may be taken at their actual market value; or (5) the unaccrued or unearned portion of any unrealized profit in any form whatever, whether in the form of notes, bonds, obligations for the payment of money, installment sales, credits or otherwise, except as provided in the preceding subparagraph (4).

. . . . . .

"III. No corporation shall pay dividends in shares of the corporation except from the surplus of the aggregate of its assets . . . over the aggregate of its liabilities, plus the amount of its capital stock." La. Acts 1928, No. 250, § 26, I, III, 1 La. Gen. Stat. § 1106.

[2] 49 Stat. 1648, 1655–1657.

Stat. 1648, 1664: The question we had to decide in those cases was whether a state constitution, corporate charter, or state statute, which prohibited payment of dividends, was a "written contract" within the meaning of the § 26 (c) (1) exemption provision. We held that we could not so expand the provision's language, relying in part upon previous statements of this Court "that provisions granting special tax exemptions are to be strictly construed." *Helvering* v. *Northwest Steel Rolling Mills*, *supra*, 49. Since the respondent here had no "written contract" against payment of dividends, it had no exemption from the surtax imposed by the original 1936 Act.

But this suit is not brought to determine the company's tax liability under the 1936 Act as it stood in the taxable years 1937 and 1938. It is an action for a refund under a 1942 relief amendment to the 1936 Act specifically designed to authorize corporations to obtain repayments of taxes they had been forced to pay under the 1936 Act as we had interpreted it. That amendment, as enacted, provided for complete or partial retroactive immunity from the 1936 undistributed profits tax under the following circumstances:

> "DEFICIT CORPORATIONS. In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936." § 501 (a) (3), Revenue Act of 1942, 56 Stat. 798, 954.

This amendment was designed to grant corporations a refund on account of payments of undistributed profits taxes for tax years in which they had an accumulated

deficit, and where, for that reason, state law, federal law, or public regulatory orders of either prohibited distribution of dividends. It therefore authorized refunds to the very taxpayers who had been lawfully required to pay taxes by the 1936 Act as we had interpreted it in the two cases cited above. Furthermore, in order to make sure that taxpayers who had paid under our interpretation might recover refunds, § 501 (c) of the same amendment specifically authorized claims for repayment to be filed within one year after its passage, without regard to any statute of limitations or other designated statutory bars. 56 Stat. 798, 955.

The Government's contention is that we should construe the word "deficit" and the phrase "accumulated earnings and profits" according to their established meaning under federal tax law; that so construed the $100,000 allotted for stock dividends remained a part of earnings and profits for tax purposes; therefore, there was no deficit in the federal tax sense, and consequently the tax payments should not have been refunded here despite the state prohibition against distribution. We may assume that the Government is correct in contending that if Congress intended in the 1942 amendment to use the words "deficit" and "earnings and profits" in this federal tax sense, the stock dividend did not reduce "earnings," there was no "deficit," and the refund should be denied. See § 115, Revenue Act of 1936, 49 Stat. 1648, 1687–1689; *Commissioner* v. *Bedford*, 325 U. S. 283, 292. This construction would greatly limit the scope of the relief granted by the 1942 amendment. To determine whether Congress intended so to limit the relief it granted, we must look to the whole 1942 amendment in its relationship to the 1936 Act and the legislative and judicial history intervening between the two.

The 1936 undistributed profits tax law was a novelty in the field of federal taxation. Its chief novel feature was

that it was designed to compel corporations to distribute current earnings to shareholders by imposing a surtax on corporations which failed to make such distributions. It had detailed provisions for defining the net income which would be reached by this tax. Its application, therefore, raised new and sometimes wholly unexpected problems. Widespread opposition developed to the tax. Since 1938, only a token of it has survived. See Revenue Act of 1938, 52 Stat. 447. But even after the 1936 undistributed profits tax was no longer in effect, complaints about its prior application from corporations which had been required to pay an undistributed profits tax continued to reach and to concern Congress. Representatives of these corporations appeared before the House and Senate Committees in 1942, and Congress responded to their complaints by enacting the several provisions of § 501—the retroactive relief legislation now under consideration.

One subject of complaint was that under the income tax definitions only a fraction of capital losses were deductible from taxable net income. Corporations which had suffered large capital losses in a given year were required to pay undistributed profits taxes in that year as though they had made a profit. The 1942 amendment, as reported by the House Committee, met this complaint by recommending that refunds be authorized for corporations who had paid under this 1936 definition of net income.[3] This au-

[3] The House Ways and Means Committee reported that § 501 of the 1942 Act allowed corporations to deduct capital losses from their capital assets for purposes of the undistributed profits tax even though only $2,000 of such capital loss was deductible from gross income for other purposes.

Another amendment provided a stock redemption credit deductible from gross income taxable for undistributed profits tax purposes.

And the breadth of the refund provision is illustrated by the provisions making the amendment effective as of the date the 1936 Act was enacted, and extending the Statute of Limitations to permit refunds for all overpayments since that date. H. R. Rep. 2333, 77th Cong., 2d Sess., 170 (1942).

thorization, subsequently, approved by the Senate Committee,[4] clearly shows that Congress intended to provide for this phase of the refund without regard to tax definitions, and did not intend its authorized refund to be restricted by the application of established tax terminology.

When the bill reached the Senate Committee, insistent complaints related to the fact that corporations with deficits in accumulated earnings and profits had been compelled to pay taxes for non-distribution of dividends although state or federal law prohibited dividend payments. A deficit railroad corporation had been taxed over its objection that payment of dividends would have rendered its officers subject to punishment for a misdemeanor under federal law and a money penalty under state law. The Board of Tax Appeals had overruled objections on these grounds, relying on our decisions in the *Crane-Johnson* and *Northwest Steel* cases, *supra*. *Paris & Mt. Pleasant R. Co.* v. *Comm'r.*, 47 B. T. A. 439.[5] The counsel who had represented Crane-Johnson before this Court also appeared on their behalf before the Senate Committee and made a plea for relief for deficit corporations which had been compelled to pay the undistributed profits tax.[6] He

[4] Sen. Rep. No. 1631, 77th Cong., 2d Sess., 244, 245 (1942).

[5] *Hearings before Senate Committee on Finance on Revenue Act of 1942*, 77th Cong., 2d Sess., 2343–2345 (1942). Counsel for another deficit railroad corporation pointed out that under governing state law that railroad's officers would have been liable for a penalty of double the damages to anyone harmed. *Id.* at 1422.

[6] Statement of Mr. John E. Hughes:

"Next I have a statement on behalf of Crane Johnson Co. that section 501 of the House bill should be simplified. That point is this: If a corporation was forbidden by State law to declare a dividend because its capital stock was impaired, it could not avoid the undistributed profits tax enacted in 1936 and was caught in a trap. A rich corporation could. It could declare a dividend and avoid it. Surely you would not discriminate against a poor one.

"Furthermore, if it had an impairment of capital stock and was organized under the laws of about one-third of the States where corpo-

urged that such corporations had been "caught in a trap," and that they were justly entitled to have a refund for that reason. It was apparently in response to the foregoing complaints that the relief provision before us, not part of the House bill as it came to the Senate,[7] was introduced by the Senate Committee.[8] We think Congress was moved to relieve those corporations which it considered to be "caught in a trap" whereby they were taxed by the Federal Government if they did not pay dividends and subject to prosecution and penalties by the Federal Government or the states if they did.

Some of the language Congress used, considered tax-wise only, provides plausible support for the interpretation urged by the Government which would give the relief amendment more limited scope. But the provision before us is not a general tax exemption to be interpreted in the framework of a currently operating general revenue law. It is a special retroactive relief measure to authorize repayment of taxes collected in previous years under a revenue law which had already been substantially abandoned. The language of this extraordinary relief measure and the circumstances which prompted its passage convince us that Congress intended to provide refunds to

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rations in such condition are allowed to declare dividends, a dividend would be a return of capital to the shareholder and no credit for the undistributed profits tax would be given.

"There is no reason for granting relief retroactively in the limited cases which may be held to be covered by the vague and ambiguous language of section 501 of the House bill without granting relief in these cases also.

"The language of section 501 is vague and ambiguous and ought to be simplified. In 1938 relief was granted as soon as this situation was brought to the attention of Congress, but unfortunately was not made retroactive to 1936. The House bill in section 501 properly makes it retroactive to 1936, but is not phrased in simple enough language."

Hearings, supra 1022. See also *id.* at 1306–1308.

[7] See H. R. Rep., note 3, *supra*.

[8] See Sen. Rep. note 4, *supra*.

corporate taxpayers, with possible minor exception, who had paid undistributed profits taxes as a choice between conflicting state and federal compulsions.

Furthermore, the very mechanics of the 1942 amendment require that determination of rights to refund under it be based on consideration of something other than the tax meaning of the 1936 Act or other tax terminology. The right to recovery in every case depends ultimately upon whether federal law or federal regulatory bodies, or state law or state regulatory bodies, prohibit payments of dividends. In this case the ultimate right to refund depends upon state law. *Cf. Lyeth* v. *Hoey*, 305 U. S. 188, 193. Before that right can be finally established, courts must examine state law at least to the extent of determining (1) what is a "deficit"; (2) what are "accumulated earnings and profits"; (3) what was the state law on these questions prior to May 1, 1936; (4) whether payments of dividends under these circumstances were prohibited by state law. Acceptance of the Government's contention would mean that courts administering the 1942 Act must first determine whether a deficit exists under federal law; if such a federal deficit exists, they must then turn to state law to decide whether under it a deficit exists such as prohibits the payment of dividends. We do not think that Congress intended the courts so to administer the 1942 amendment. The Government's argument that it does relies heavily upon the Senate Committee Report.

We think the Senate Committee Report, as a whole, leans toward the view we have taken of the purpose of the law.[9] But in one of the six illustrative examples of application of the new tax relief provisions of the amendment.

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[9] Sen. Rep. 1631, note 4, *supra*, outlining § 501 of the proposed Revenue Act of 1942 stated:

". . . (A) new paragraph . . . has been added, providing for an additional credit in cases of corporations having a deficit in accumu-

and in the subsequent Treasury Regulations, it was indicated that no tax credit should be allowed where a tax deficit resulted from "prior capitalization of surplus in the course of a non-taxable reorganization."[10] Aside from the fact that corporate reorganizations and simple stock dividends are quite different things, we find this one illustrative example insufficient to outweigh the considerations which have governed our interpretation of the 1942 amendment.

We are persuaded that Congress at least intended by the amendment to refund taxes imposed on corporations which had failed to distribute dividends when distribution, in

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lated earnings and profits and prohibited by law from paying dividends and . . . a new subsection has been added providing for a stock redemption credit.

"Section 501 . . . grants relief from the undistributed profits tax for taxable years beginning after December 31, 1935, and prior to January 1, 1938, by allowing as an additional credit in computing undistributed net income the portion of the adjusted net income which, in certain instances, could not be distributed as taxable dividends. . . .

"Under § 14 of the Revenue Act of 1936 corporations in general were subject to surtax at various rates from 7 to 27 per cent of their undistributed net income. In some instances State law or an order of a public regulatory body prohibited payment of dividends during the existence of a deficit even though the corporation had current earnings and profits which would constitute undistributed net income under the definition thereof in § 14 (a) (2). Such corporations were, therefore, subject to undistributed profits surtax even though they were prohibited by law from paying dividends. The addition of the new paragraph 3 to subsection (c) of section 26 to provide an additional credit in the amount of the deficit in accumulated earnings and profits as of the close of the preceding taxable year is intended to give relief in certain of these cases.

"Also under § 14 of the Revenue Act of 1936, it was possible that the undistributed net income of a corporation might exceed accumulated and current earnings and profits. In such case the tax could not be avoided even if distributions were made to shareholders." The amendment was to provide relief in this situation also.

[10] *Id.* at 246.

violation of state law, would have impaired long-existing state approved corporate capitalizations. See *United States* v. *Byron Sash & Door Co.*, 150 F. 2d 44, 46. In order that this purpose may be effected, the judgment of the Circuit Court of Appeals is

Affirmed.

SUPREME COURT OF THE UNITED STATES

No. 430.—October Term, 1946.

The United States of America, Petitioner, v. Ogilvie Hardware Company, Inc.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[April 7, 1947.]

Mr. Justice Frankfurter, with whom Mr. Justice Reed joins, dissenting.

The Revenue Act of 1936 imposed a surtax on undistributed corporate profits. Section 26 (c) (1) gave relief from this surtax under defined circumstances.[1] In *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, it was held that although a restriction on the distribution of corporate profits was imposed by State law, a credit for such withheld profits was not authorized by § 26 (c) (1). In reaching this conclusion, the Court took into account that it "has been said many times that provisions granting spe-

[1] 49 Stat. 1648, 1664.

"In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

. . . . . .

"(1) Prohibition on payment of dividends. An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account."

cial tax exemptions are to be strictly construed." *Helvering* v. *Northwest Steel Mills, supra*, at 49. By way of relaxing the restricted scope which this Court gave to exemption from the undistributed profits tax, Congress, by the Revenue Act of 1942, substituted a new subdivision (3) to § 26 (c) of the Revenue Act of 1936: This section did not undo the *Northwest Steel Mills* doctrine. It did not allow a deduction for profits forbidden to be distributed by State law, as it had, in § 26 (c) (1), allowed credit for profits undistributed because of a "written contract." Congress gave relief for earnings forbidden to be distributed by State law only "In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year. . . ."[2]

This is tax language and should be read in its tax sense. We must not disregard the illumination of an authoritative tax lexicon in reading tax legislation. The language of the 1942 amendment carries with it tax usage, tax practice, and the gloss of authoritative legislative history. All combine to make the condition under which State law prohibiting distribution of profits comes into play, that which Congress in words of art said was the condition, namely, the existence of "a deficit in accumulated earnings and profits." Here there was no deficit in the controlling sense of the term. And nothing warrants the attribution of a non-technical meaning to so settled a technical term. Nothing, that is, except the suggestion that to give the 1942 amendment this established meaning might not afford the relief that, as a mater of abstract

[2] Section 501 (a), Revenue Act of 1942, 56 Stat. 798, 954. "(3) DEFICIT CORPORATIONS.—In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936."

justice, should be afforded. But this is merely an attempt to invoke what has been called the "equity" of a statute. I am no friend of artificial canons of construction, and I would not strain language in order to construe tax exemptions strictly. On the other hand, Revenue Acts are not the kind of legislation which should be loosely construed in order to grant exemptions.

The legislative history of this enactment and the administrative practice only reenforce what seems to me to be the compelling requirement, to render technical terms used by Congress with their technical meaning. If it be suggested that counsel for taxpayers at a Congressional hearing urged the fairness of the construction which the Court now places upon what Congress has expressed, it would not be the first time that the final legislation of Congress did not satisfy the desire of some of its proponents. In any event, I do not think the argument of counsel for a taxpayer urging relief should carry more weight than the use by Congress of settled tax language, carrying a meaning which excludes that result, a meaning which is reenforced by the legislative, judicial and administrative history that led up to and followed the enactment. See *Century Electric Co.* v. *Commissioner*, 144 F. 2d 983, affirming the Tax Court, 3 T. C. 297; S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 244–46; Treasury Regulations, 94 and 101, Art. 115–11; Treasury Regulations 103, § 19.115–11; Treasury Regulations 111, § 29.115–11. The short of the matter is, that even though corporate profits here were withheld because Louisiana forbade their distribution, there can be no credit allowed for a deficit because in a federal tax sense there was no deficit.

No doubt Congress, to some extent, desired to relieve from the undistributed profits tax corporations forbidden by State law from declaring dividends. But neither what Congress enacted nor its legislative history indicates a purpose to disregard the limiting provisions of § 115 (h) of

the Revenue Act of 1936.[3] This section, which embodies the analysis of *Commissioner* v. *Sansome*, 60 F. 2d 931, see S. Rep. 2156, 74th Cong., 2d Sess., p. 19, requires that in respect to federal taxes, assets be treated as available for distribution as earnings regardless of stock dividends which capitalize earnings and profits. H. Rep. No. 2894, 76th Cong., 3d Sess., p. 41, cited in *Commissioner* v. *Wheeler*, 324 U. S. 542, 546. The specific example cited by the Senate Committee Report on § 501 of the Revenue Act of 1942 shows that Congress intended to limit the relief afforded by the amendment to cases where the deficit in question had not resulted from the capitalization of accumulated earnings and profits.[4] The majority finds a difference between capitalization of earnings in a nontaxable reorganization and capitalization of earnings by a simple stock dividend. The circumstances are different

[3] 49 Stat. 1648, 1688–89. § 115 (h): "EFFECT ON EARNINGS AND PROFITS OF DISTRIBUTIONS OF STOCK.—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—

"(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or

"(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act. As used in this subsection the term 'stock or securities' includes rights to acquire stock or securities."

[4] S. Rep. No. 1631, 77th Cong., 2d Sess., pp. 245–46:

"(1) The X corporation for the calendar year 1936 had an adjusted net income of $200,000 . . .

"(2) Assume in the above example that the deficit in accumulated earnings and profits is $20,000 for income tax purposes, but the deficit in accumulated earnings and profits on the corporation's books by reason of a prior capitalization of surplus in the course of a nontaxable reorganization amounts to $250,000. In this case, although the State

but the difference is not significant for the legal effect of the stock dividend on earnings and profits. The example given is concerned with the effect of capitalizing earnings and profits, not with the method. If Congress meant to relieve undistributed earnings and profits even though those earnings and profits were considered available under § 115 (h), it should have said so.

We think the judgment of the Circuit Court of Appeals should be reversed.

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law would probably prohibit payment of any dividends, the credit allowed under the amendment to section 26 (c) is limited to $20,000, which is the deficit in accumulated earnings and profits for income tax purposes. X corporation, therefore, will be liable for undistributed profits surtax on $180,000 of its adjusted net income."